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Supreme Court of the United States

No. 720.....

TERM A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

—o—

IN THE CAUSE

OF

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit, and Brief in Support Thereof.

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Abbreviations.

G. & A. Ry.—Georgia and Alabama Railway.

System—Seaboard Air Line Railway Company.

Ct. Op.—District Court's Opinion.

Ct. Tr.—District Court Transcript of evidence of hearings held before Judge Chesnut and Judge Akerman jointly in Baltimore on Plan of Reorganization.

S. M. Tr.—Special Master's Transcript of evidence of hearings before Hon. Tazewell Taylor.

S. M. Rep.—Special Master's Report—Volume II.

Comp. Com.—Compromise Committee.

App.—Appendix.

Dist. Ct.—District Court.

Cir. Ct. Op.—Circuit Court of Appeals' Opinion.

All references made in this brief to the District Court Transcript and Special Master's Transcript of evidence as well as the Court Exhibits and Special Master's Exhibits are included for the Court's convenience in Appellant's printed appendix, Vol. I, unless otherwise noted.

Supreme Court of the United States

No. .....

TERM A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

In the Cause

of

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of F. G. Badenhausen, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the Holders of Georgia and Alabama Railway

First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945, respectfully shows:

Summary Statement of the Matter Involved.

The petitioners seek a review of the final determination of the United States Circuit Court of Appeals for the Fourth Circuit, dated August 2, 1944, which affirmed the decree of the District Court of the United States for the Eastern District of Virginia, entered on December 13, 1943, approving and confirming the Report of the Special Master and the Plan of Reorganization of the Seaboard Air Line Railway Company, recommended in said Report with certain modifications.

Petitioners constitute a Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Bonds, Due 1945, one of the Underlying Mortgage issues of the Seaboard System.

Facts as to Seaboard System.

The Seaboard Air Line Railway Company has been in receivership in this Court for more than thirteen years.

These proceedings were inaugurated by the Bill of Complaint filed in the Receivership Court on December 23, 1930 by Bethlehem Steel Company, a general creditor, against Seaboard Air Line Railway Company, defendant, suing on its own behalf and on behalf of all other creditors who might thereafter join in the prosecution of said suit. The defendant Seaboard Air Line Railway consented to the Receivership. Ancillary proceedings were instituted on the same day in the District Court of the United States for the Southern District of Florida.

Thereafter, on January 15, 1931, Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees of the First and Consolidated Mortgage of Seaboard Air Line Railway Company, filed their foreclosure bill against

the Seaboard System and its Receivers. Similar foreclosure bills were filed thereafter by the other general system mortgagees, to wit, the Trustees of the First Mortgage and the Trustees of the Refunding Mortgage. Subsequently, suits were instituted by several of the Trustees of the underlying mortgages, as well as by several of the Trustees of the mortgages on leased lines. In addition, a proceeding under Section 77 of the Bankruptcy Act was instituted for the reorganization of the Tampa Northern Railroad Company, a leased line.

However, pursuant to the authority granted the Seaboard Receivers by the Seaboard Receivership Courts, and with the approval of the Courts having jurisdiction over the other various properties including the leased lines or subsidiaries of the Seaboard System, the Receivers of Seaboard have remained in possession and have continued to operate all the properties of the System. As a result there was pending at the time the Special Master's Report was filed, in addition to the general creditors' suit, the following foreclosure bills: Three brought by the Trustees on the general system mortgages; seven brought by the Trustees of underlying mortgages, and two brought by the Trustees of mortgages of leased lines, as well as the proceeding under Section 77 of the Bankruptcy Act as to another leased line (the District Court subsequently directed that foreclosure proceedings should be instituted by the Trustees on the remaining lines in order to consummate the Plan of Reorganization in Equity Receivership). No action has been taken by the Trustee under the Seaboard Air Line Railway Adjustment Mortgage, the entire lien of which is subordinate to that of the Seaboard Air Line Railway Refunding Mortgage.

The present Seaboard Air Line Railway Company was organized in 1915 and is a successor to three successor Companies, each known as Seaboard Air Line Railway. It owns and operates more than 4,000 miles of railroad.

Included in the more than 4,000 miles of railroad owned by the Seaboard are over 2,000 miles which are subject to ten separate underlying divisional mortgages. The total principal and unpaid interest on which (held by the public) as of January 1, 1943, amounted to $48,549,767.20. Subordinate to these underlying liens, but constituting first liens on certain portions of the whole railroad system are four general mortgages known as (1) First Mortgage 4% bonds due April 1, 1950; (2) Refunding Mortgage 4% bonds due October 1, 1959; (3) First and Consolidated Mortgage 6% bonds, series A, due September 1, 1945, and (4) Adjustment Mortgage 5% bonds due October 1, 1949. The total principal and interest of these general mortgage bonds publicly held, aggregates $160,439,473.33. In addition there are $36,806,862.55 of Seaboard collateral trust obligations. The general unsecured claims against the Seaboard not entitled to priority of payment ahead of mortgage liens (as of August 1, 1942), principal and interest, amounted to $1,193,723.97). The par value of the outstanding capital stock of the Seaboard Air Line Railway Company, preferred and common, aggregates $85,110,662.21. During the course of the receivership the Receivers incurred obligations represented by outstanding receivers' equipment trust certificates in the amount of $13,531,000, and receivers' certificates in the amount of $23,128,000, and other indebtedness, aggregating in all $38,412,882.37. The grand total of principal and interest of the secured debt in the hands of the public is $221,362,460.25, on which there is unpaid interest amounting to $118,889,124.39, a total of principal and interest of $340,251,484.64, exclusive of capital stock.

During the course of the receivership, principally in the last two years, the Receivers have purchased and acquired about $34,000,000 par value of outstanding receivers' certificates and other secured obligations of the System. Nearly all of the securities were acquired by

the Receivers under orders of court to the effect that the application of the moneys therefor should be without prejudice to the claims of parties in interest with respect to the application of the moneys so used. And during the receivership the Receivers have also applied upwards of $50,000,000 in betterments to the railroad system.

During the receivership several efforts were made by the Court to effect a Plan of Reorganization. In 1935, the Court instructed the Receivers to prepare a Plan of Reorganization. Extended studies and tentative proposals were made by the Receivers but the then relatively poor earnings of the railroad caused the principal secured creditors to oppose further procedure along this line at that time; and the Receivers were then excused by the Court from further activities in that direction. On October 27, 1939 the Court entered an order appointing Tazewell Taylor, Esq., as Special Master, to prepare and submit a Plan of Reorganization after hearing all parties in interest. The appointment was made pursuant to Rule 53 of the Rules of Civil Procedure. The Master conducted hearings, took evidence for a period of over three years, considered various plans of reorganization and on July 20, 1943, submitted his Report which is included in this Record on Appeal.

After the receipt of the Report, Judge Way entered an order notifying the parties in interest to file any objections or exceptions which they wished to make to said Report, and set the date for hearing the same on October 18, 1943. Exceptions and objections to the Plan of the Special Master were filed by many parties including the petitioners herein. The hearing was adjourned (due to the regrettable illness and subsequent death of Judge Way) to October 25, 1943, when the hearing was held jointly by Judge Chesnut, sitting for the United States District Court, Eastern District of Virginia, and Judge Akerman, sitting for the United States District Court, Southern Dis-

trict of Florida, the presiding Judge in the ancillary proceedings. All parties in interest were heard for a period of two weeks and further evidence was submitted. At the close of these hearings, on the objections to the Plan, the Court appointed a Compromise Committee composed of three representatives of *certain* secured creditors to consider and propose modifications of the Plan of Reorganization submitted by the Special Master with the view that it should compromise, if possible, *all* conflicting claims. The Committee consisted of Messrs. Delano Andrews and Edwin S. S. Sunderland who represented the Bondholders Protective Committee and Trustees, respectively, of the First and Consolidated 6% Mortgage of the Seaboard System, the third member, Mr. France, who was counsel for the Underlying Bondholders Committee, which had on deposit bonds of all ten of the Underlying Mortgage Divisions purported to represent all of these *conflicting* mortgage divisions. The Compromise Committee adopted the attitude it was functioning in a *judicial capacity* rather than as a negotiating or arbitrating body (Vol. I, Comp. Com. Exh. 1, pp. 415, 417, 418, 420).* The Committee, after purportedly hearing certain interested parties objecting to the Plan, submitted its recommendations and report for modification of the allocation of the new securities. A further hearing was then held on these proposed modifications by the Compromise Committee, before the District Court. At the hearing and in their Report, the Compromise Committee gave no reasons nor did they explain the methods by which they obtained the results they recommended but stated that the results were obtained from the exercise of an informed judgment (Vol. I, Comp. Com. Exh. I, p. 418). Thereafter the Plan submitted by the Special Master, with the modifications recommended by the Compromise Committee, was adopted by the District Court.

*Numerical references are to pages contained in appellants' printed Appendix of Record on Appeal designated Vol. I unless otherwise noted.

The District Court found that the Seaboard was insolvent according to both the equity and bankruptcy definitions. It found that the unsecured debt and stock of the Seaboard railroad were not entitled to participate in a reorganization because the new capitalization would be insufficient to fully satisfy the claims of the holders of the secured debt (Vol. I, Dist. Ct. Op. p. 91).

Facts as to the Georgia and Alabama Railway.

The Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Bonds, Due October 1, 1945, are a first mortgage lien on approximately 393.53 miles of railroad in the States of Georgia and Alabama, extending generally from Savannah, Georgia, westward to Montgomery, Alabama. The mortgage carries a lien on equipment acquired for use on the mortgagor's line of railroad. There is a lease between the Georgia and Alabama Railroad and the Central of Georgia Rd. dated March 28, 1896, covering an additional 57.48 miles of main track from Meldrin, Georgia, to Lyons, Georgia, at an annual rental in the sum of $43,000.

There are Georgia and Alabama bonds issued and still outstanding in the principal sum of $6,085,000 with accrued interest due and unpaid in the sum of $3,803,125. The total claim amounts to $9,888,125 or $1.625 per $1,000 bond.

The valuation of the G. & A. Ry. as fixed by the Master in his Plan of Reorganization was $1,419,029. The Master's Plan of Reorganization allocated to the bondholders of G. & A. Ry.:

Income Bonds	$1,599,640—Valued at	$799,820
Preferred Stock	659,797—Valued at	164,949
Income Stock	3,748,748—Valued at	468,594
Total	$6,008,185—Valued at	$1,433,363

Under the Master's Plan each Georgia and Alabama bond on which there was accrued principal and interest in the sum of $1,625 received the following:

Income Bond	$260.25
Preferred Stock	107.35
Common Stock	609.90
Total Face Value	$977.50

In his allocation of new securities, the Master allocated all of the First Mortgage Bonds of the new company only to such divisions as have shown earnings under a segregation formula adopted by him, known as the "Kennedy Segregation Formula."

In his allocation of Income Bonds the Master allocated fifty per cent. of the Income Bonds on the basis of segregated earnings and fifty per cent. on the basis of net value of freight contributions. In his allocation of Preferred Stock and Common Stock, the Master has allocated one-third on the basis of segregated earnings, one-third on the basis of net value of freight contributions and one-third on the basis of reproduction costs new, less depreciation including land and rights of way (Vol. II, S. M., Report, pp. 227 to 258).

Under the Master's Plan, G. & A. Ry. received no First Mortgage Bonds due to the fact that under the Master's Segregation Formula, G. & A. Ry. showed no segregated earnings.

Under the Master's Plan, G. & A. Ry. in view of the net value of its freight contributions received Income Mortgage Bonds in the sum of $1,599,640, Preferred Stock in the sum of $373,903 and Common Stock in the sum of $2,129,517.00.

Under the Master's Plan the estimated cost of reproduction new less depreciation of the G. & A. Ry. including

land and right as of December 31, 1941 is $7,886,829. Based on this valuation, the Master's Primary Allocation allots to the G. & A. Ry. Preferred Stock in the sum of $285,894 and Common Stock in the sum of $1,619,231.

As stated heretofore, during the course of the receivership and principally, in the 1942 and 1943 years the Receivers have purchased and acquired $34,000,000 outstanding Receivers' certificates and other secured obligations of the System (Vol. I, Dist. Ct. Op. p. 90). These securities were purchased by the Receivers with funds which were principally acquired from the huge wartime earnings accumulated during the years 1942 and 1943. The net earnings for the Seaboard System for the year 1942 were $34,566,102 and the net earnings for the Seaboard System for the year 1943 were estimated at about $28,000,000 (Vol. I, Dist. Ct. Op. pp. 96, 123). The purchase of these securities and cash provisions subsequently provided for other issues, released for reapportionment large amounts of new securities which were originally allotted by the Master in his Primary Allocation to these purchased securities and outstanding issues under his Plan of Reorganization. The effect or result of these purchases was to require a Secondary Allocation which would reallot these securities to the remaining secured creditors of the Seaboard System.

Under the Master's Plan, the Secondary Allocation was to be reallotted solely on the basis of the segregated earnings which were based on the earnings of the average year for the period 1936 to 1940, predicated on the "Kennedy Segregation Formula" (Vol. II, M. Rep., 235-258). Under the Master's Plan the G. & A. Ry. did not participate in the Secondary Allocation as it purportedly failed to show any segregated earnings during the period of 1936 to 1940. No consideration was given to the fact that in 1942, when the huge wartime earnings were accumulated by the System, the G. & A. Railway Division earned $1,016,937 (Vol. I, Wyer, Ct. Exh. 1, p. 409) and

that its earnings in 1943 were probably 1½ to 2 million dollars (Vol. I, Ct. Tr. 158-163).

It was recognized by the District Court and practically all of the parties in interest that these huge wartime earnings were entirely due to traffic contributed by the various underlying divisional lines and that all the underlying divisional lines were earning huge sums during the years 1942 and 1943, particularly those lines which under the Special Master's Segregation Formula on the basis of the average year for a period of 1936 to 1940 were denoted as "deficit lines" (Vol. I, Ct. Tr. 325-327, 346-347, 360; Comp. Com. Exh. 1, p. 419). It was contended by the petitioners that the Secondary Allocation of the new securities should be made in a court of equity on an earnings basis to the owners of those properties whose earnings produced the cash used by the Receivers to acquire the released securities and not on a pre-war earnings basis predicated on the period 1936 to 1940, when the earnings of the System were on a much lower level.

The Compromise Committee recognized and admitted the fairness and soundness of this principle, in its report (Vol. I, Comp. Com. Exh. 1, p. 419), and recommended the adoption of the Tertiary Allocation (Vol. I, Comp. Com. Exh's. 2 and 4, pp. 426, 428).

The Tertiary Allocation in effect distributed some of the new securities released by the Receivers' recent purchasers among the various mortgage liens on the basis that they were dividends earned, and being paid, for a period of two years, on the securities originally alloted by the Special Master to the several mortgages, in his two prior allocations, *but* the Tertiary Allocation was *not* applied to *all* the securities released for reapportionment by reason of the Receivers' purchases from wartime earnings. The Tertiary Allocation applied to only a small portion of the new securities released; the bulk of the securities, released by the Receivers' wartime pur-

chases or cash provisions subsequently provided for certain mortgage issues, were distributed under the Master's Secondary Allocation, which was based purely on segregated earnings shown under the Kennedy Formula for the average year 1936 to 1940. It will be noted that in effect the approved Plan of Reorganization contains three different allocations: The Primary and Secondary Allocations recommended by the Master and the Tertiary Allocation which partially modified the Secondary Allocation with respect to a portion of the securities released by the Receivers' recent purchases from wartime earnings.

It will be further noted that the District Court, in approving the Modified Plan of Reorganization, was under the erroneous impression (as indicated in its opinion Vol. I, p. 119, fol. 355) that a block allotment had been made to the Georgia and Alabama Division in the modifications recommended by the Compromise Committee. On the contrary, no such block allotment appears in the record, other than that granted to the Atlantic-Birmingham Division, which consisted of First Mortgage Bonds in the sum of $280,057, Income Bonds $320,392, Preferred Stock $55,457 and Common Stock $315,266. The additional securities received by the Georgia and Alabama Division are solely the result of the Tertiary Allocation made to all of the divisions and this fact was admitted by the respondents in their brief before the Circuit Court of Appeals.

As a result of the Tertiary Allocation, Georgia and Alabama Railway received the following additional securities: First Mortgage Bonds $357,408; Income Bonds $13,983; Preferred Stock $3,262; Common Stock $28,614. The additional securities are valued at $368,798, making a total valuation of all securities received by the Georgia and Alabama Railway in the amount of $1,787,871 (Vol. III, p. 27).

Under the Plan of Reorganization as modified by the Court, the bondholders of the G. & A. Ry. receive the following securities per $1,000 bond:

1st Mortgage	*Income Bond*	*Pref. Stock*	*Com. Stock*
58.74	262.55	107.88	614.61

The total face value of the above securities amounts to $1,043.78 whereas the total first lien claim of each G. & A. bond for principal and accrued interest to Jan. 1, 1944 is $1,625.

This Court Has Jurisdiction.

The jurisdiction of this Court to review the judgment here in question is invoked under the Act of February 13, 1925 (C. 229; 43 Stat. 938) amending the Judicial Code, Sec. 240, Title 28, U. S. C. A., Sec. 347, and under Rule 38, subdivision 5, of the Rules of the Supreme Court.

The date of the entry of the judgment of affirmance of the Circuit Court of Appeals sought to be reviewed is August 2, 1944 (Vol. III, pp. 39-40). By order of Mr. Chief Justice Harlan F. Stone dated Oct. 27, 1944 the time to file the petition herein has been extended to Dec. 2, 1944.

To avoid repetition and in the interest of brevity a statement of the actual grounds on which the jurisdiction of this Court is invoked under Rule 38 subdivision 5 of the Rules of the Supreme Court is not presented here and petitioners respectfully refer the Court to the following portions of this petition, which present these questions fully.

Questions Presented.

The questions presented herein involve important questions of both procedural and substantive law, which call for their most authoritative determination. It is contended that the procedure adopted by the District

Court and sanctioned by the Circuit Court of Appeals exceeded the jurisdiction of the Court and so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's jurisdiction. The substantive questions set forth must be considered to determine the basic problem of whether the allocation of new securities, to be issued in the approved Plan of Reorganization among the various classes of mortgagees having claims of equal rank against different properties, is fair and equitable.

1. Did the District Court err in proceeding to reorganize the Seaboard System in equity, after the passage of Section 77 of the Bankruptcy Act?

2. Did the appointment by the District Court of a Compromise Committee consisting only of representatives of certain partisan interests, which purported to act in a judicial capacity upon issues affecting the petitioners as well as the other bondholders of the System, violate the due process of law guaranteed by the Federal Constitution?

3. Did the Circuit Court of Appeals, in sanctioning the procedure of the District Court with respect to the Compromise Committee, so far depart from the accepted and usual course of judicial proceedings or so far sanction such a departure by a lower court as to call for an exercise of this Court's power of supervision?

4. Do the allocations of securities to the various classes of bondholders, recommended by the Compromise Committee and adopted by the District Court, have any basis for their support in law or in fact, or were they arbitrary determinations made in violation of the due process clause contained in the Federal Constitution?

5. Did the Circuit Court of Appeals and District Court err in using the same level of earnings as a base for the distribution of junior securities as well as for the distribution of senior securities?

6. Was the distribution of wartime earnings and redistribution of securities released by purchases from the huge wartime earnings on a pre-war basis predicated solely on what each of the mortgage divisions earned in the period 1936 to 1940 under the Secondary Allocation adopted by the Courts below, fair and equitable to all the mortgage divisions, particularly those divisions whose properties produced such earnings but who showed no segregated earnings during the average period of 1936 to 1940?

7. Did the failure of the Special Master and the courts below to apply the "Kennedy Segregation Formula" to the recent earnings in the years 1941 to 1943 render the results so obtained obsolete and hence inequitable?

8. Was the "Segregation Formula" adopted by the lower Courts to ascertain the earnings of the various mortgage divisions of the System which primarily determined the allocation of most of the new securities, equitable, based upon false, artificial and inequitable assumptions?

9. Was the weight given by the Master and the Courts below to the socalled "segregated earnings" of the different mortgage divisions under the adopted "Kennedy Formula", predicated on false and artificial assumptions, equitable?

10. Did the District Court err in determining the earnings and relative value of the Georgia and Alabama Division by considering it as a separately operating railroad instead of as part of a System operated as a unit?

11. Were the G. & A. Railway Bondholders fairly and equitably compensated for the full amount of their claims and the loss of their first mortgage position?

Reasons Relied on for Allowance of Writ.

1. The decision of said Circuit Court of Appeals, approving the procedure of the District Court in proceeding to reorganize the Seaboard Railway System in equity, after the passage of Section 77 of the Bankruptcy Act, is in direct conflict with the decision of the Circuit Court of Appeals, Second Circuit, on the same matter, in the case of *New England Coal & Coke Co.* v. *Rutland Railroad Co.*, 143 Fed. 2nd 179. The Circuit Court of Appeals, Second Circuit held that, before the enactment of Section 77. railroad reorganizations in equity were approved because the Bankruptcy Act was not applicable to railroad corporations and reorganization in equity was necessary in the public interest, but that, after the enactment of Section 77 that reason for condoning such a receivership has vanished and equity reorganization is now "a means for the frustration of the public policy of the United States, embodied in Section 77".

The decision of said Fourth Circuit Court of Appeals, affirming the correctness of the procedure and jurisdiction of the District Court, to proceed with the reorganization of a railroad in equity receivership, after the enactment of Section 77 of the Bankruptcy Act, involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38, par. 5[b]). The question involved has a public aspect and is of public importance to all railroads now in the process of reorganization, and it is essential in the public interest that the question be reviewed and finally settled.

2. The decision of said Circuit Court of Appeals, sanctioning the procedure adopted by the District Court,

of appointing a Compromise Committee consisting of representatives only of certain major and partial interests to act in a judicial capacity upon issues and allocations before the District Court, was improper, erroneous, violated the due process of law guaranteed by the Federal Constitution, and so far departed from the accepted and usual course of judicial proceedings or so far sanctioned such a departure by a lower court as to call for an exercise of this Court's power of supervision (Supreme Court Rule 38, par. 5[b]).

All of the members of the Compromise Committee had prejudicial interests. Two members of the Compromise Committee represented the Bondholders Protective Committee and the Trustees, respectively, of the System's First and Consolidated Six Per Cent. Mortgage, the largest General System Mortgage, which acted for all of the System General Mortgages. The third member of the Committee appointed and the only representative of the Underlying Mortgage Divisions was counsel for the "Underlying Bondholders Committee", which purportedly represented *all* ten of the Underlying Divisions because it had on deposit substantial amounts of bonds of all the Underlying Mortgage Divisions. A *conflict of interest* existed between each one of the Underlying Mortgage Divisions since the treatment received by each division was different under the proposed Plan. This conflict of interest became more apparent and pronounced between the socalled "earning divisions" and "deficit divisions". The G. & A. Division under the Segregation Formula adopted was designated a "deficit division". It became apparent early in the proceedings that the Underlying Bondholders Committee favored the socalled "earning divisions" represented by it.* The petitioners attacked the position of the Underlying Bondholders Committee and filed a petition** before the Dis-

*This fact was admitted at a subsequent hearing on the petition hereinafter mentioned.

**This petition was subsequently denied by the District Court and an appeal from this decision is now pending before the Circuit Court of Appeals.

trict Court during the course of the proceedings to direct the Underlying Bondholders Committee to cease to represent the Bondholders of the Georgia and Alabama Railway, in view of the sharp conflict of interest which existed between each of the various liens. This position, petitioners contended, was fully supported by this Court in the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262. It is apparent from the record that the attitude of the Underlying Committee and its counsel toward the Georgia and Alabama petitioners and representatives was a most hostile one and that the presence of the counsel for the Underlying Bondholders Committee on the Compromise Committee was not conducive to improving the treatment of the G. & A. Bondholders.

Nevertheless, the Compromise Committee asserted in its report that they were acting as judicial officers of the Court and were exercising an *impartial informed judgment* as to the various adjustments recommended by said Committee (Vol. I, Comp. Com. Ex. 1, pp. 415, 417-418, 420). The Compromise Committee gave no reasons and did not explain the methods by which it obtained the results it arbitrarily recommended, but stated they were obtained from the exercise of an informed judgment (Vol. I, Comp. Com. Exh. 1, pp. 415, 417-418, 420). The modifications recommended by the members of the Compromise Committee were in effect a judgment in their own favor. The District Court's approval in Equity of the Plan of Reorganization as modified was predicated substantially upon the fact that most of the Debenture Holders had assented to the Plan (Vol. I, Dist. Ct. Op., pp. 134, 137, 141-142). It is clear that the just and equitable rights and claims of a minority group of creditors should not be prejudiced or waived through the coercion of a majority of the other secured creditors who would benefit thereby (*First National Bank* v. *Flershem*, 290 U. S. 504, 515-516;

New England Coal & Coke Co. v. *Rutland Railroad Co., supra*). The District Court in accepting the arbitrary modifications recommended by a partial Compromise Committee, without any basis in law or fact for the support of said modifications, violated the due process of law guaranteed by the Federal Constitution.

3. The decision of said Circuit Court of Appeals, holding that it was correct for the District Court to use the same level of earnings as a base for the distribution of junior securities as well as for the distribution of senior securities, is a decision of a federal question in a way probably untenable and in conflict with applicable decisions of this Court (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pac. R. R. Co.*, 318 U. S. 561, 563) (Supreme Court Rule 38, par. 5[b]).

It is estimated that if a higher level of earnings was adopted for the distribution of junior securities predicated for example on the actual 1942 earnings, the Georgia and Alabama Division would have received additional junior securities in the following amounts: Income Bonds $780,000; Preferred Stock $150,000; Common Stock $850,000.

4. The Circuit Court of Appeals erred in approving the allocation made to the G. & A. bondholders under the Plan of Reorganization, where the District Court and the Special Master admittedly failed to apply the Segregation Formula to or consider the recent earnings in the years 1941 to 1943. The results so obtained were obsolete and violated Section 77, subdivision (e) of the Bankruptcy Act which provides that the value of any property used in railroad operation shall be determined on a basis which shall give due consideration to the earning power of the property, *past, present and prospective*, and all other relevant facts.

5. The Circuit Court of Appeals erred in affirming the Master's Secondary Allocation approved by the District Court. The Secondary Allocation re-distributed securities released by purchases from recent wartime earnings, on a pre-war earnings basis, and gave no consideration whatsoever to the recent earnings of each of the various Mortgage Divisions whose properties produced such earnings in the years 1941 to 1943. The question as to whether the wartime earnings (or securities released by purchases from wartime earnings) in a railroad reorganization, should be distributed among the various Mortgage Divisions on an actual earnings basis during those years *when* they were *acquired* or whether the funds and securities so acquired should be distributed among the various Mortgage Divisions on a *pre-war basis* and in different pre-war ratios, contrary to the actual facts, has never been adjudicated by this Court, so far as our research indicates. It involves an important question of federal law of great importance to the public and other railroads presently in reorganization. It involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38, par. 5[b]).

In the instant case the securities involved and which must be redistributed are in excess of $34,000,000. Under the Secondary Allocation adopted by the lower Courts most of these securities have been distributed to the various mortgage divisions on an earnings basis made in a synthetic average year for the period 1936 to 1940. Many of the mortgage divisions showed no net earnings during this period and were designated as "deficit lines" in these years under the Segregation Formula adopted, whereas in the years the wartime earnings were accumulated all of these socalled "deficit lines" admittedly became huge earnings lines which produced much of the cash or equivalent securities now being distributed in

which they do not participate. It is estimated that the Georgia & Alabama division would have received additional securities in the amount of $1,315,800 if all the released securities were properly reallocated.

6. The decision of the said Circuit Court of Appeals approving the results obtained under the Segregation Formula adopted by the District Court was erroneous, for the following reasons:

(a) The Segregation Formula was predicated upon the false and artificial premise that each Mortgage Division was a separate operating railroad. The Segregation Formula should have been based upon the consideration and ascertainment of the relative earnings of each Division as a part of one System operated as a unit.

(b) To ascertain the earnings of each mortgage division as a base for establishing the consequent relative value of the several divisions, the earnings intended to be ascertained were the earnings of the System through the use and operation of each mortgage division, not the earnings of each segment, as if it were a separately operating railroad.

(c) The Segregation Formula adopted attempted to put precise mathematical values on each separate division of the Railroad System without considering or ascertaining their relative value to the System.

7. There is no rule of law which prescribes the criteria for the determination of earnings of separate railroad divisions in one system. The principles and rules adopted by the District Court and affirmed by the Circuit Court of Appeals for the ascertainment of the earnings as well as the relative values of the separate railroad divisions which comprised the Seaboard System, involve important questions of federal law which

have not been but should be settled by this Court, and have been decided in a way probably in conflict with applicable decisions of this Court. Under Section 77 of the Bankruptcy Act these questions and principles have been left to the expert and informed judgment of the Interstate Commerce Commission but the Interstate Commerce Commission does not have authority to determine these questions in an equity receivership. The reorganization of railroads, both in equity and bankruptcy has become increasingly frequent and it may reasonably be assumed from past experience that such reorganizations will occur in the future. It is essential in the public interest that the questions here presented be reviewed and finally settled.

8. The interests at stake and the number of persons affected are very substantial. Involved herein is the distribution among various secured creditors of securities in the sum of approximately $197,000,000. Involved also are the rights of many thousands of general creditors spread throughout our land who rightfully look to the courts for a fair and equitable administration and distribution of this insolvent estate, nor is this merely a controversy between private interests in the usual sense, since the questions involved concern hundreds of thousands of investors who daily trade in these securities and others of similar character.

The public interest and administration of justice will be subserved by this Court's review and by the correction of the patent discrimination and injustice which petitioners believe to inhere in this proceeding.

Wherefore your petitioners respectfully pray that a writ of certiorari issue under the seal of this Court directed to the Circuit Court of Appeals for the Fourth Circuit, commanding said Court to certify and send to

this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court, had in the case numbered on its Docket 5249, to the end that this cause may be reviewed and determined by this Court, as provided for by the statutes of the United States, and that the judgment herein of said Circuit Court be reversed by this Court, and for such other relief as to this Court may seem proper.

Dated, November 27, 1944.

ABRAHAM MITNOVETZ,
Counsel for Petitioners.

HARRY O. LEVIN,
Of Counsel.

Supreme Court of the United States

No. .....

TERM A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

—o—

IN THE CAUSE

OF

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

Brief in Support of Petition for Writ of Certiorari.

ABRAHAM MITNOVETZ,
Attorney for Petitioners.

HARRY O. LEVIN,
Of Counsel.

Brief in Support of Petition for Writ of Certiorari.

Opinions Below.

The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is not yet officially reported. The opinion is printed in full in the printed Appendix to the Record on Appeal (Vol. III, 9-39).

The opinion of the United States District Court for the Eastern District of Virginia is reported in 53 F. Sup. 672. The opinion is also printed in full in the printed Appendix to the Record on Appeal (pp. 81-145).

The Special Master's Report is designated as Vol. II in the Record on Appeal.

Jurisdiction.

The jurisdiction of this Court to review the judgment here in question is invoked under the Act of February 13, 1925 (C. 229; 43 Stat. 938), amending the Judicial Code Section 240, Title 28, U. S. C. A., Section 347, and under Rule 38, subdivision 5, of the Rules of the Supreme Court. A statement of the grounds on which the jurisdiction of this Court is invoked is contained in a petition pursuant to Rule 38 (5) (b), filed herewith, *supra*, pages 15-21, and petitioners respectfully request that said statement be deemed incorporated in the Brief at this point. Judgment was entered in this case on August 2, 1944 (Vol. III, 39-40). The time to file the petition herein has been extended to December 2, 1944 by order of this Court.

Statement of the Case.

The essential facts of the case are presented in the petition filed herewith (*supra*, pp. 2-12) to which petitioners respectfully refer. In the interest of brevity, the facts are not repeated here. It will be noted, however, that there are no controverted issues of fact in this case.

Specification of Errors.

1. The District Court erred in proceeding to reorganize the Seaboard Railroad System in equity, after the passage of Section 77 of the Bankruptcy Act. The Circuit Court erred in sanctioning this procedure.

2. The Circuit Court of Appeals and the District Court erred and violated the due process of law guaranteed by the Federal Constitution in adopting the allocations and modifications in the Plan of Reorganization recommended by a Compromise Committee consisting only of representatives of certain partisan interests which purported to act in a judicial capacity over issues affecting the petitioners as well as the other bondholders of the System.

3. The Circuit Court of Appeals, in sanctioning the procedure of the District Court with respect to the Compromise Committee, so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

4. The Circuit Court of Appeals, in approving the allocations of securities recommended by the Compromise Committee to the various bondholders and adopted by the District Court without any basis for the support thereof in law or fact, erred and violated the due process of law guaranteed by the Federal Constitution.

5. The Circuit Court of Appeals and District Court erred in using the same level of earnings as a base for the distribution of junior securities as well as for the distribution of senior securities.

6. The Circuit Court of Appeals erred in approving the Secondary Allocation adopted by the District Court,

which distributed large portions of the wartime earnings and securities released by wartime earnings on a pre-war basis predicated solely on what each of the mortgage divisions earned in the period 1936 to 1940 without considering what each mortgage division earned during the years these funds were accumulated.

7. The Courts below erred in failing to apply the "Segregation Formula" adopted by them to the recent earnings in the years 1941 to 1943.

8. The Courts below erred in adopting the "Kennedy Segregation Formula" to ascertain the earnings of the various mortgage divisions of the System which was based upon false and artificial assumptions and which primarily determined the allocation of the new securities to the various divisions.

9. The Courts below erred in giving predominant weight to the socalled "segregated earnings" of the different mortgage divisions as ascertained under the adopted Kennedy Formula which was predicated on false and artificial assumptions.

10. The Plan of Reorganization approved by the District Court and Circuit Court of Appeals is erroneous in that it fails to fairly and equitably compensate the Georgia and Alabama Bondholders for the full amount of their claims and the loss of their first mortgage position.

POINT I.

The District Court erred in proceeding to reorganize the Seaboard Railroad System in Equity after the passage of Section 77 of the Bankruptcy Act.

The decision of the Circuit Court of Appeals approving and affirming the procedure of the District Court in reorganizing the Seaboard Railroad System in equity, after

the passage of Section 77 of the Bankruptcy Act, is in direct conflict with the decision of the Circuit Court of Appeals, Second Circuit, on the same matter, in the case of *New England Coal & Coke Co.* v. *Rutland Railroad Co.*, 143 F. (2d) 179.

The Circuit Court of Appeals, Second Circuit, has in effect said that the continuance of equity receivership proceedings after the enactment of Section 77 of the Bankruptcy Act is now "a means for the frustration of the public policy of the United States as embodied in Section 77." In the instant case the District Court and Circuit Court of Appeals proceeded to approve a Plan of Reorganization in equity long after the passage of Section 77 of the Bankruptcy Act (Vol. III, pp. 23-25, Cir. Ct. Op.).

The conflict between the two Circuit Courts of Appeal involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38, par. 5[b]). The question involved has a public aspect and is of primary importance to all railroads now in the process of reorganization and it is essential in the public interest that the question be reviewed and finally settled.

The major problems which have arisen before the District Court are a result of the extraordinary procedure which has heretofore taken place. As appears throughout his Report, the Master herein has endeavored to act as if he were the Interstate Commerce Commission, to act as if this were a proceeding before that body, and to substitute his judgment in place and stead of that of the Commission (Vol. I, Ct. Tr., pp. 246-247).

Counsel, herein, argued before the District Court at its first hearing that the two questions generally presented in a railroad reorganization, to wit: (1) What kind of capital structure should be devised and (2) In what manner shall the new securities be allocated among the holders of the various divisional liens, are questions peculiarly

requiring the informed, expert and impartial judgment of the Interstate Commerce Commission. It is an impartial and expert administrative body with an experienced staff devoted to these types of problems, necessary particularly when an allocation of securities is required among holders of different divisional liens whose claims are of equal rank (see Ct. Tr., pp. 1004-1006 in Rec. on Appeal). The District Court likewise remarked that the burden should be on the Interstate Commerce Commission (see Ct. Tr., p. 1659 in Rec. on Appeal).

In the instant case, the learned Master was an experienced railroad attorney who was familiar with the Seaboard Railroad System. As a matter of fact, the Master originally instituted the Seaboard Receivership as solicitor for the Bethlehem Steel Company, when he filed its bill of complaint as a general creditor. The Special Master admitted, however, that he was no railroad expert (Vol. I, Ct. Tr., 246, 247). With all due respect to the learned Master, there is hardly any basis of comparison as to his qualifications, experience and competence with that of the Interstate Commerce Commission.

In *Ecker* v. *Western Pacific R. Co.*, 318 U. S. 448, 468, 469, this Court, referring to Section 77 said:

> "Since railroads could not take advantage of the Bankruptcy Act, Section 4, 11 U. S. C. A., Section 22, their final adjustments for years have been carried out in equity receiverships under judicial control. * * * These reorganizations require something more than contest between adversary interests to produce plans which are fair and in the public interest. When the public interest, as distinguished from private, bulks large in the problem, the solution is largely a function of the legislative and administrative agencies of

government with their facilities and experience in investigating all aspects of the problem and appraising the general interest. Congress outlined the course reorganization is to follow. It established standards for administration and placed in the hands of the Commission the primary responsibility for the development of a suitable plan."

The District Court in its opinion stated:

"Before the passage of the Act of Congress (in 1933) providing for railroad reorganization as a part of the Bankruptcy Law (Section 77) the only juridical mode of railroad reorganization was in equity. Since then it may be thought that equity for such a purpose is outmoded but not outlawed (Vol. I, Dist. Ct. Op., pp. 138-139). * * * It is true that equity procedure in corporate reorganizations had heretofore in many cases proved unsatisfactory and this was the primary reason which prompted the enactment of Section 77 and 77B of the Bankruptcy Act" (Vol. I, Dist. Ct. Op. p. 142).

This same problem however was discussed in the case of *New England Coal & Coke Co.* v. *Rutland Railroad Company, supra,* by the Circuit Court of Appeals for the Second Circuit. After fully and carefully analyzing the various cases applicable thereto, Judge Frank said:

"From those cases we deduce the following: Before the enactment of 77 in 1933 a consent receivership of a railroad was condoned because the Bankruptcy Act was not applicable to such a corporation and such a receivership was therefore often necessary in the public interest to make possible the continued operation of the railroad and

> its preservation as a unit. Since the enactment of Section 77 however, that reason for condoning such a receivership has vanished and it is now *'a means for the frustration of the public policy'*, of the United States embodied in Section 77." (Emphasis supplied.)

And quoted Rep. Rayburn, Chairman of the House Committee in charge of the bill which became Section 77, who said:

> "I believe therefore that in order to protect stockholders, in order to protect bondholders, in order to protect everyone who is a creditor of a railroad, and the public as well, we should pass this or some other legislation at the earliest hour to put an end to these long drawn out, these expensive and in many instances these disgraceful receiverships that have happened in the past."

Although the *"Rutland Railroad"* case, cited *supra*, went into receivership in 1938 *after* the enactment of Section 77 of the Bankruptcy Act and the Court there also held that the original petition was defective, the principles enunciated by the Circuit Court of Appeals, Second Circuit, are equally applicable to the instant case and is authority to the effect, that if a plan of reorganization is to be developed for a railroad, it must, since the enactment of Section 77 of the Bankruptcy Act be consummated under Section 77.

Although in the instant case, the Seaboard System went into receivership in 1931, no attempt was made to reorganize until 1935 when the Court instructed the Receivers to prepare a Plan of Reorganization but it was abandoned after the principal secured creditors opposed procedure along this line, in view of the then relatively poor earnings of the railroad. Several years later on

October 27, 1939, the Court again entered an Order appointing the Master to consider, prepare and submit a Plan of Reorganization, after hearing all parties in interest, but it was not until July, 1943, that the Master finally submitted his Report and proposed Plan of Reorganization.

The District Court, after the Compromise Committee proposed its modifications as hereinafter set forth (see Point II), confirmed the Master's Plan as modified by the Compromise Committee, under the mistaken belief of the Court that it was the duty of the Court to aid in effectuating the Plan of Reorganization in Equity since a very large majority of the debenture holders had assented to it. This inference clearly appears from the Opinion of the District Court (Vol. I, 134, 137, 141-142).

It is clear that the rights and claims of a minority group of creditors, if their claims are just and equitable, should not be prejudiced or waived through the coercion of a majority of the other secured creditors whose interests would benefit thereby.

> *First National Bank* v. *Flershem*, 290 U. S. 504, 515-516, 525-562;
>
> *New England Coal & Coke Co.* v. *Rutland Railroad Company, supra.*

Nevertheless, the approval of the instant Plan in Equity seems to have been predicated by the District Court substantially upon the fact that most of the debenture holders in the instant case had assented to the Plan (Vol. I, Dist. Ct. Op., pp. 115, 126-128, 134, 137, 141-142). This is likewise true of the Circuit Court of Appeals (Vol. III, pp. 30, 31).

POINT II.

The Circuit Court of Appeals erred and violated the due process of law guaranteed by the Federal Constitution in sanctioning the appointment by the District Court of a Compromise Committee consisting only of representatives of certain partisan interests, which purported to act in a judicial capacity over issues affecting the petitioners, as well as the other bondholders of the system.

The Circuit Court of Appeals, in sanctioning the procedure of the District Court with respect to the Compromise Committee, so far sanctioned a departure by a lower court from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The allocation of securities recommended by the Compromise Committee and approved by the lower Courts, were arbitrary and illegal, without any basis for their support in law or in fact.

At the close of the first hearing the District Court rendered its tentative views on certain of the issues. In discussing the unfairness of the results of the Master's Plan with respect to the G. & A. Ry., the Court stated:

> "Furthermore, I think that a great deal of influence ought to be given to the recent earnings which are now causing emphasis on the contest that we have. Just how those recent earnings ought to be influential in what is the final allocation of securities is largely a business question. I think we were told during the hearings that the Georgia & Alabama had made net earnings of something over a million dollars in the last year or two and that they are awarded securities on the basis here in the plan which would not amount to much more

than that; furthermore, that the scrap value of the Georgia & Alabama is pretty nearly as much as the market value of the securities that are awarded to it. Those things cry out for adjustment and just how they can be adjusted is much more a matter of good business judgment than it is merely of legal principles" (Vol. I, Ct. Tr., p. 360).

The District Court then discussed the practical or business aspect of deciding the issues before the Court on a *compromise basis* rather than on a legal or judicial basis in order to expedite the reorganization, at this particular time, when the earnings of the System were at their highest level (Vol. I, Ct. Tr., pp. 365-368). (See Rec. on Appeal Ct. Tr., pp. 1314-1386). The Court suggested that a Compromise Committee be appointed to negotiate with the interested parties, whose rights appeared to be adversely affected by the Master's Plan, so that a Plan of Reorganization be confirmed which would be agreeable *by consent* to all interested participating parties (Vol. I, Ct. Tr., pp. 365-368). (See Ct. Tr., pp. 1369-1381 in Record on Appeal.)

The Court appointed Messrs. Edwin S. S. Sunderland, Delano Andrews and Joseph France. Mr. Andrews represented the Bondholders Protective Committee and Mr. Sunderland represented the Trustees, respectively, of the System First and Consolidated 6% Mortgage. These gentlemen were nominated as the spokesmen for all of the general mortgages. The third member of the Committee appointed was Mr. France, Counsel for the Underlying Bondholders Committee, which had on deposit, bonds of *all* the underlying mortgage divisions although their interests unquestionably conflicted.

This Compromise Committee is understood to have conferred with all of the interested parties, but seemed subsequently to be laboring under the conception that

they were acting in a *judicial* capacity rather than as a compromising or negotiating body. This attitude appears throughout the entire Report of the Committee (Vol. I, Compromise Com., Exh. I, pp. 415, 417-418).

The absurdity of these assertions that the Compromise Committee were acting as judicial officers of the Court and were exercising an *impartially informed judgment* as to the various adjustments made, is apparent from the actual facts as evidenced by the entire record. The District Court stated on several occasions at the first hearing that the Master's Plan was, if anything, much too favorable in so far as the general mortgages were concerned and unsatisfactory as to the underlying divisions (Rec. on Appeal, Ct. Tr., pp. 607-608). Mr. Sunderland and Mr. Andrews unquestionably favored the confirmation of the Master's Plan *in toto* at all times, although they urged certain minor exceptions (see Rec. on Appeal, Ct. Tr., p. 1345) (Vol. I, Comp. Com. Exh. I, pp. 417-418). On the other hand, the various representatives of the several underlying liens on the whole strenuously objected to the Master's Plan. The Underlying Bondholders Committee, which purportedly represented *all* ten of the underlying liens, had always favored the socalled "earning" underlying divisions and for all practical purposes had abandoned the true representation of the socalled "deficit" divisions, just as it had abandoned representing a subsidiary, Georgia & Alabama Terminal, whose bonds still were on deposit and represented (Vol. I, Ct. Tr., p. 399). Petitioners made this charge early in the proceedings, when they filed a petition praying the Court to direct the Underlying Committee to cease to represent the bondholders of the G. & A. Ry., in view of the sharp conflict of interest which existed between each of the various lines.* This conflict of interest among the under-

*This petition was subsequently denied by the District Court and an appeal from this decision is now pending before the Circuit Court of Appeals.

lying divisions became more apparent and pronounced between the socalled *"earning"* divisions and *"deficit"* divisions. It is not unfair to say that the only active representatives of any of the socalled "deficit" divisions were the petitioners herein. Although this issue has been unfavorably decided by the District Court, it is respectfully submitted petitioners' contention is fully supported by the Supreme Court in the case of *Woods* v. *City National Bank & Trust Company of Chicago, et al.*, 312 U. S. 262, decided February 3, 1941.

For the members of the Compromise Committee to assert that they were acting impartially and as judicial officers of the Court is ridiculous. Each one was an interested party in the proceedings and strongly partial to his own interests. Furthermore, it is inconceivable in American jurisprudence that anyone should or could act in a judicial capacity in a proceeding where their own interests are involved.

It is likewise apparent from the record that the attitude of the Underlying Committee and its counsel toward the petitioners as representatives of the Georgia and Alabama Division, was a most hostile one. This was further evidenced by the testimony of the Underlying Committee's expert, Mr. Wyer, who was in fact the strongest opposition witness in so far as the Georgia and Alabama Bondholders were concerned. It is clear that the presence of the counsel for the Underlying Bondholders Committee on the Compromise Committee was not conducive to improving the treatment of the Georgia and Alabama Division, which probably accounts for the poor treatment it received.

The Securities and Exchange Commission, in discussing this same problem in its "Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, made pursuant to Sec. 211 of the Securities and Exchange Act of 1934", stated:

"Above all things, see to it that neither your Committee nor any other committee represent conflicting interests. It is a rule to which there are few exceptions that the same protective committee should represent but one class of securities. * * * If the interests of the several classes of Security-holders are not to suffer as a result of concession too readily or unnecessarily made, their representatives at the conference table should have *undivided* loyalty to the class which they represent" (Report, Part II, p. 395). (Italics ours.)

A compromise necessarily is based upon the consent of all interested parties. In the instant case, the G. & A. Ry. Protective Committee, the petitioners herein, at no time accepted or agreed to the modifications proposed by the Compromise Committee. As a matter of fact the proceedings of the Compromise Committee were kept highly secretive. No indication was given by the Compromise Committee of what the recommended modifications as to the various issues would be until the very day of the hearing, when the recommendiations were arbitrarily submitted by the Compromise Committee without any explanation whatsoever as to the manner or *methods* in which they obtained these results or the *reasons* for these results, except that it was stated that they were obtained from an impartial informed judgment (Vol. I, Comp. Com. Ex. I, pp. 415, 417-418, 420). Wyer, the Underlying Bondholders Committee's expert, testified that he could not subscribe to the *methods used* for obtaining the compromise but was in favor of its results (See Rec. on App. Ct. Tr., p. 1416). Kennedy, the First and Consolidated General Mortgage expert, testified likewise.

It may be stated unequivocally that the modifications made by the members of the Compromise Committee were

in effect, a judgment in their own favor. All of the members of the Compromise Committee had prejudicial interests. The securities they actively advocated and represented at the hearings, benefited substantially in the results of the modifications proposed by them. It must be remembered that the real interest of *all* the members of the Compromise Committee lay in the treatment which the so-called "*earning*" divisions received under the Master's Formula. As stated by the District Court the principal objection of the Underlying Committee was in the treatment of deficits, which affected only the socalled "*earning*" divisions. The Master disregarded the "deficits" of the mortgaged and leased lines which had the mathematical effect of charging same to all of the underlying divisions which were "earning" divisions (Vol. I, Dist Ct. Op., pp. 116-117).

The Compromise Committee settled this issue by charging the deficits on the underlying mortgage divisions against the System mortgage having the next junior lien on the property in question or where there was no junior lien, as in the case of leased lines, by distributing the deficits *pro rata*. This resulted in improving the treatment of the underlying "earning" divisions which were actively represented by Mr. France. On the other hand, it was to the interest of the general mortgages to improve the treatment of the socalled underlying "earning" divisions but not the "deficit" divisions. The reason for this is, that the general mortgages in addition to having a first lien on certain of the underlying "earning" divisions also had a second lien on the other underlying "earning" divisions and the *surplus* of "earnings" went to the general mortgages after satisfying in full the claim of the divisional first mortgage. Thus, the general mortgages would gain nothing if they improved the treatment of the "deficit" divisions as the first mortgages on these divisions would still not be paid

in full and that there would be no surplus to go to the general mortgages (Vol. III, p. 16, Cir. Ct. Op.).

This is further illustrated by their approval of the Master's Secondary Allocation as well as by the Tertiary Allocation proposed by the Compromise Committee. In their Report, the Committee stated that it recognized the fundamental of fairness and equity in providing for distribution of normal war earnings to holders of securities *whose properties have produced such earnings* and also referred to similar recognized proposals on other proceedings (Vol. I, Comp. Com. Ex. I, p. 419). They stated they gave effect to this principle by the use of the Tertiary Allocation, which was only *partially true*. This Tertiary Allocation is predicated upon the assumption that the Primary Allocation and Secondary Allocation proposed by the Master is correct and proceeds, in effect, to distribute the additional released securities as if they were declared dividends on the securities originally allocated on the same basis as developed by Wyer's Court Exh. No. 3 (Vol. I, p. 441). A comparison of the results appears on the Comp. Com. Exh. 4 (Vol. I, p. 428).

However, this Tertiary Allocation is only applied to the securities released by the cash provisions made for the acquisition of Tampa Northern, and Georgia, Florida and Alabama bonds. As the District Court in its opinion (Vol. I, p. 125) states, after making certain block allotments therefrom (which have never been specified in the District Court Record), the balance of new securities so released and distributed amounted to $539,980 First Mortgage Bonds, $450,676 in Income Bonds, $105,136 par value Preferred Stock and $992,203 par value Common Stock.

However, as previously stated, during the last two years and with the wartime earnings, the Receivers have purchased and acquired about *$34,000,000* par value of outstanding Receivers' certificates and secured obligations of the System which have released for redistribution corre-

sponding amounts of new securities. It will be seen therefore, that the amount of securities which were purchased from wartime earnings and which are purportedly distributed to the holders of those securities whose properties have produced such earnings (as proposed in the Tertiary Allocation) is minute as compared to the actual securities so purchased. The vast bulk of such securities, including the securities released from the purchases of Receivers' certificates in excess of $34,000,000 are all allocated *only* on the *basis of the segregated earnings*, as established by the "Kennedy Formula", during the period of *pre-war* and low level earnings, to wit, 1936 to 1940, which is known as the Secondary Allocation. Mortgage divisions, such as the G. & A. Ry. which are highly valuable and which have contributed heavily to these cash purchases during the wartime period receive no part of these securities, since they show no segregated earnings in 1936 to 1940. Since the Tertiary Allocation is predicated on the Secondary Allocation, as well as the Primary Allocation, the error is multiplied (Vol. III, pp. 26-27, 34-35, Cir. Ct. Op.).

In conclusion, it is interesting to compare the increase in the allocation of securities recommended by the Compromise Committee with respect to the G. & A. Division and the Atlanta and Birmingham Division, as shown in the Compromise Committee's Exhibit #4 (Vol. I, p. 428).

G. & A. Ry. receives the following increase:

First Mortgage Bonds	*Income Bonds*	*Preferred Stock*	*Common Stock*
$361,018	$14,125	$3,295	$28,904

Total Increase $407,342.

ATLANTA AND BIRMINGHAM.

First Mortgage Bonds	*Income Bonds*	*Preferred Stock*	*Common Stock*
$976,210	$605,869	$106,036	$614,144

Total Increase $2,302,259.

Yet it will be noted after comparing Wyer's Court Exhibit No. 1 (Vol. I, p. 411) and the Compromise Committee's Court Exhibit No. 8 (Vol. I, p. 433), that the earnings of the G. & A. Ry. equalled the earnings of the Atlanta Birmingham Division in 1942 and probably exceeded it in 1943, in view of Wyer's testimony that the Georgia and Alabama Division probably earned 1½ million to 2 million dollars in 1943 (Vol. I, Ct. Tr. 370-371).

The approved Plan of Reorganization and the allocations made therein is unfair on its face.

POINT III.

The Secondary Allocation adopted by the District Court and approved by the Circuit Court of Appeals, which redistributed most of the cash and securities released by the huge wartime earnings on a pre-war basis predicated solely on what each of the mortgage divisions earned in the period 1936 to 1940 is unfair and inequitable and involves an important question of federal law which has not been but should be settled by this court.

The decision of the Circuit Court of Appeals (Vol. III, p. 34) approved the Secondary Allocation adopted by the District Court which redistributed most of the securities released by the *wartime* earnings on a *pre-war basis* predicated solely on what each of the mortgage divisions earned

in the period 1936 to 1940. Its failure to consider the recent earnings of the mortgage divisions whose properties produced such earnings in the years 1941 to 1943, is not only inequitable but involves an important question of federal law which has not been but should be settled by this Court.

The question as to whether the wartime earnings (or securities released by purchases from wartime earnings) in a railroad reorganization should be distributed on an actual earnings basis during those years *when* they were *acquired* or whether the funds and the securities so acquired should be distributed, among the various mortgage divisions, on a *pre-war* basis and in different pre-war ratios, contrary to the actual facts, has never been adjudicated by this Court so far as our research indicates. It involves an important question of federal law of great importance to the public and other railroads presently in receivership or bankruptcy.

It must be emphasized that in the point now being considered, the petitioners *do not* contend that wartime earnings can serve as a reliable criterion for the indefinite future. The problem here is entirely different. The problem involves the redistribution of securities released or cash obtained from wartime earnings which have been *actually earned*, among various first mortgage divisions of equal rank. It must be recognized that there is a great distinction between using wartime earnings as a base for establishing future earnings and the consideration of wartime earnings as actually earned; one is based *in futuro*, the other is an *accomplished fact*.

In the instant case huge amounts of cash have been rapidly accumulated by the Seaboard System from the current earnings, particularly during the years 1942 and 1943, (and probably 1944). This surplus cash has been applied to the payment of senior claims and other secured obligations of the System. The purchase of these securities have materially reduced the claims which

were originally admitted to participation in the new corporation and have released equivalent amounts of the new securities of the permitted capitalization for redistribution among the various mortgage divisions.

In the instant case the securities which must be redistributed are in excess of $34,000,000; nearly all of the securities were purchased and acquired by the Receivers under orders of the Court to the effect that the application of the moneys therefor should be without prejudice to claims of parties of interest with respect to the application of moneys so used (Vol. I, Dist. Ct. Op., p. 90).

Under the Secondary Allocation adopted by the Courts below, most of these securities have been distributed to the various mortgage divisions on an earnings basis made in a synthetic average year for the period 1936 to 1940. Many of the mortgage divisions including the Georgia & Alabama Railway showed no net earnings during this period and were designated as "deficit lines" under the Segregation Formula adopted, whereas in the years the wartime earnings were accumulated, all of these socalled "deficit lines" admittedly became huge earning divisions which produced much of the cash or equivalent securities now being distributed in which they do not participate.

The Compromise Committee in its report stated:

> "It may well be noted that as to the fundamental principle of fairness and equity in approving for distribution the abnormal war earnings to holders of securities whose properties have produced such earnings, generally similar proposals, different in method and form, have been made and have been or are being dealt with in railroad reorganization proceedings pending before the Interstate Commerce Commission and the federal courts" (Vol. I, p. 419).

The Compromise Committee stated that they gave effect to this principle by the use of the Tertiary Allocation. Unfortunately the Compromise Committee *failed to practice what it preached.* The Tertiary Allocation only applied to a small proportion of the securities and cash released by the wartime earnings. In so far as the balance and bulk of the $34,000,000 securities obtained from wartime earnings were concerned, to which the Tertiary Allocation was *not applied,* the District Court and Circuit Court of Appeals adopted the Secondary Allocation proposed by the Master, which re-allocated the released securities solely on the basis of the earnings in the socalled average year in the period 1936 to 1940. It must further be noted that the Tertiary Allocation distributes the released securities as if they were declared dividends on the securities previously allocated to the various mortgage divisions. It follows that the Tertiary Allocation is predicated on the assumption that the previous allocations are correct and in effect multiplies the errors indicated in the Primary and Secondary Allocations.

It will be seen that the present Plan of Reorganization in reality consists of three distinct allocations—the Primary, Secondary and Tertiary Allocations.

In the Primary Allocation, the first mortgage bonds allotted to the underlying mortgaged properties were allocated among the so-called earning divisions on the basis of their average segregated earnings for the period 1936 to 1940, with certain adjustments. The income mortgage Bonds were allocated to the various divisions, one-half on the basis of segregated earnings, and the other half on the basis of the net value of freight contributions, with the exception, that the 7½ million of such Income Bonds originally allotted to Receivers' certificates, purchased by the Receivers were reallocated wholly on the basis of segregated earnings. The preferred and common stock were allocated one-third on the basis of segregated earn-

ings, one-third on the basis of the net contributions to freight traffic and one-third on the basis of reconstruction cost new less depreciation (Vol. I, Dist. Ct. Op., p. 107).

In the Secondary Allocation proposed by the Master and adopted by the Court, except for the minor Tertiary Allocation, the first mortgage bonds and junior securities which had been primarily allocated to Receivers' certificates and to certain bond issues acquired by the Receivers were reallocated *only* on the basis of *segregated earnings* indicated in the period 1936 to 1940. This Secondary Allocation, based upon segregated earnings only, was also made applicable to all other securities which would be released through the purchase of senior securities by the Receivers in the future (Vol. I, Dist. Ct. Op., p. 125).

The Tertiary Allocation consisted of a minor allocation of new securities which were released by the cash provisions made for the acquisition of Tampa, Northern and Georgia, and Florida and Alabama bonds pursuant to a modification recommended by the Compromise Committee (Vol. I, Dist. Ct. Op., p. 125).

The Secondary Allocation in substance provides that *most* of the securities acquired or cash earned in the boom years of 1942, 1943 as well as 1944, if available for distribution, be distributed irrespective of the actual source, on the basis of segregated net earnings which each division made in a synthetic average year in the period 1936 to 1940 (with the exception of the small quantity of securities to which the Tertiary Allocation was applied).

It now appears that the war traffic is carried in substantially different proportions as between the various mortgaged properties than was the pre-war traffic. The earnings which will have produced the accumulated cash and resulting release of the new securities are the fruits of the various mortgaged properties in ratios quite dif-

ferent from those assumed by the Secondary Allocation adopted in the approved Plan of Reorganization.

All of the increase in earnings is due to additional traffic contributed by the various divisional mortgaged properties. In principle, to equitably redistribute these funds or securities, the re-allocation of such new securities *should be made* by a court of equity upon an earnings basis, to the owners of those properties whose earnings contributed the cash applied by the Receivers for the purchase of these securities. Any funds which were thus applied to the purchase of outstanding securities by the Receivers were unquestionably earned in 1942 and 1943. Therefore this provision in the approved Plan of Reorganization is *very unfair* to those underlying mortgage divisions now showing earnings or greatly increased earnings in years such as 1942, 1943 and 1944, when the volume of traffic and the System earnings are at much higher income levels than the years 1936 to 1940 to which the Segregation Formula was only applied (Vol. I, Ct. Tr., p. 201).

The "Master's Formula" had not been applied to the years 1941, 42 and 43, so that he had no segregation of earnings for these years (Vol. I, Ct. Tr., 222-224) which would have indicated the many changes in earning position which factually have taken place between the mortgaged properties to increase the total System operating revenue from an average of $42,800,000 for the period 1936 to 1940 to $110,400,000 in 1942 and $137,000,000 (as estimated for 1943 (Vol. I, Dist. Ct. Op. p. 96). The mortgage divisions with no earnings or with marginal earnings in such low years not only greatly increased their earnings in these boom years, but also reduced the ratio of their operating expense much faster than the divisions with high net earnings in the years of low gross revenue. As previously stated, this is a phenomena which applies to all operating railroads where the volume of business in-

creases substantially and is clearly proven by Wyer's Court Exh's. 1 and 2 (Vol. I, 409-410).

Wyer's Court Exh. 1 (Vol. I, 409) and his testimony which was not refuted proved that the G. & A. Ry. earned in 1942 under the Kennedy Formula $1,016,937 and on the same basis in 1943 approximately 1½ to 2 million dollars. Yet under the Master's Secondary allocation, G. & A. Ry. received nothing since it showed no segregated earnings in the periods selected, 1936 to 1940.

It is estimated that if the Tertiary Allocation had been applied to *all* the securities released by wartime earnings in the years 1942 and 1943, the Georgia and Alabama Divison would have received additional securities in the amount of $1,315,800.

Is not each mortgage equitably entitled to the income produced by its property during the receivership proceeding? Is it not unfair and inequitable to disregard the source of this cash and distribute the cash or equivalent securities on the basis of the different pre-war ratios? (See Swaine Railroad Reorganization under Sec. 77 of the Bank. Act, Harvard Law Review, Vol. LVI, pp. 1221-1224, July, 1943).

POINT IV.

The decision of the Circuit Court of Appeals holding that it was correct for the District Court to use the same level of earnings as a base for the distribution of junior securities as well as senior securities is erroneous and in conflict with applicable decisions of this court.

In attempting to determine the net earnings of each mortgage division the period selected for the ascertainment of earnings is equally as important as the Segregation Formula adopted (Vol. I, Ct. Tr., 154-159; fols. 461-477). In the instant case, from the standpoint of the Georgia and

Alabama Railway particularly, the period selected, 1936 to 1940, inclusive, were all unusually poor earning years, with the exception of the year 1936 (Vol. I, Dist. Ct. Op., p. 115).

The expert, Wyer, testified that the earnings for the period 1932 to 1939 were abnormal and probably would be the lowest earnings in the history of the Seaboard (Vol. I, Ct. Tr., 197-198; fol. 592). Furthermore, both experts, Wyer and Kennedy, testified that several of these years which were used as a yardstick, will not be repeated (Vol. I, Ct. Tr., pp. 154-156, 196-199, 229).

The District Court adopted this period of low level earnings proposed by the Special Master in order to establish a conservative capitalization, particularly in so far as *fixed charges* were concerned (Vol. I, Ct. Tr., pp. 197-198; fols. 589-596).

After ascertaining the net income for the average year in the period 1936 to 1940, the Master and District Court used this as a base to ascertain and thereby fix the amount of new First Mortgage Bonds to be issued (Vol. I, Ct. Tr., p. 249).

These First Mortgage Bonds were then distributed to the mortgage divisions which showed earnings during its low level period, in ratios proportionate to their relative earnings. If the mortgage division showed no segregated earnings during this period 1936 to 1940, it received no First Mortgage Bonds (Vol. III, p. 22, Cir. Ct. Op.).

However, the District Court, in distributing junior securities, to wit, Income Bonds, Preferred and Common Stock, used the same level of earnings for such distribution as it did for the distribution of the senior securities or First Mortgage Bonds. In other words, if a mortgage division showed no segregated earnings in the low level period adopted, 1936 to 1940, it not only failed to receive First Mortgage Bonds but also failed to receive any Income Bonds, Preferred Stock or Common Stock, which was dis-

tributed on a segregated earnings basis. This was erroneous. Both experts, Kennedy and Wyer, opposed this treatment (Vol. I, Ct. Tr., pp. 209-213, 201, 244-246).

The evidence introduced supported the allocation of First Mortgage Bonds on a segregated earnings basis established in the period 1936 to 1940 since it was sufficient only to meet the fixed charges required for the payment of interest on all the First Mortgage Bonds. But there was no evidence to support the use of this period for the allocation of junior securities (Vol. I, Ct. Tr., pp. 198-201, 209, 213, 276-279). The Special Master and District Court used the same earnings basis in distributing junior as well as senior securities, instead of first ascertaining the level of earnings commensurate with that required to meet the charges upon each grade of junior securities before making its distribution of the different grades of securities (Vol. I, Ct. Tr., pp. 198-201, 209-213).

In other words, the District Court fixed certain low annual charges (indicated by the Kennedy synthetic average year net revenue) which it said the System earnings would certainly cover, no matter what happened, and this was payable as interest on all the First Mortgage Bonds. The court then, in effect, said, if there were more earnings, they will be paid out on the Income Bonds, but only if the funds were earned. This was likewise true of the Preferred Stock and Common Stock.

The principle, however, is entirely different from that applied by the District Court in its distribution of First Mortgage Bonds. One is based on fixed charges, and the other is based on income which is paid only if earned. In order to earn money which can be used to pay the interest and dividends on the junior securities, it is apparent that the System must earn *above* the level fixed in the period of 1936 to 1940, since these earnings are devoted entirely to the payment of interest on the first mortgage bonds (Vol. I, Ct. Tr., pp. 198-201, 209-213).

In order to do so, the System and necessarily the various mortgage divisions must actually earn much more than originally contemplated in the *synthetic* average year. If the System and the mortgage divisions do earn more money which can be applied to the payment of interest on the income bonds and possibly dividends on the stock, what actually happens is that the earnings ratio of each mortgage division changes, and the earnings of the G. & A. Ry., as well as all the other so-called "deficit lines", would have to be much greater, in which event, it follows that they are entitled to a more equitable distribution.*

This fact is most forcibly and clearly demonstrated by Wyer's Court Exhs. 1 and 2 (Vol. I, 409-410). These exhibits (on the same basis used by Kennedy to compute the earnings of the other years in 1936 to 1940), applied the "Kennedy Formula" to the System's earnings for the year 1942 in order to ascertain the earnings of the G. & A. Ry. and South Bound Divisions in the year 1942. Wyer's Ex. 1 showed that under the "Kennedy Formula" and after all adjustments required therein, the G. & A. Ry. in 1942 had a gross income in the sum of $1,016,937—or an actual increase in earnings in 1942 of $1,230,242 as compared with the 1939 results under the "Kennedy Formula". At the same time, the exhibit showed that the operating ratio of costs as compared with the railroad operating revenues for 1942 was 65.4% as compared to 86.6% for the year 1939. This phenomena applies to all operating railroads; if the volume of business increases substantially, not only does the gross revenue increase proportionately, but the ratio or percentage of operating costs decreases as well. The effect is twofold (1) an increase in the gross revenue, and (2) a decrease in the normal operating expense. Kennedy and Wyer both testified that the level of earnings used for the distribution of junior securities should always

*See Swaine Article (*supra*) Harvard L. Rev. (July, 1943), pages 1215-1217.

be, equitably, at a much *higher level* than that used for the distribution of senior securities, since no interest or dividends could be received on these junior securities unless the level of earnings was much higher and produced the income necessary for that purpose (Vol. I, Ct. Tr., pp. 209-213; 244-246).

In discussing the same problem in the *Milwaukee* case, *supra*, Mr. Justice Douglas, 318 U. S. 561, 563, said:

> " * * * But where as here each group of bondholders is contributing to a new system mortgage separate properties from old divisional mortgages, it is necessary to fit each into the hierarchy of the new capital structure in such a way that each will retain in relation to the other the same position it formerly had in respect of assets and of *earnings at various levels.* * * * No fixed rule supplies the method of bringing two divisional mortgages into a new capital structure so that each will retain in relation to the other the same position it formerly had in respect of assets and of *earnings at various levels.*" (Italics supplied.)

It is clear from the Special Master's Report (Vol. II, pp. 256-258) that the District Court distributed 50% of the income bonds and 33 1/3% of all of the preferred and common stock solely upon the basis of the segregated earnings of each division, in the period 1936 to 1940, under the formula adopted. It is also clear that if the segregated earnings period adopted for the partial distribution of junior securities was based on earnings for the year 1942, instead of earnings based on the period 1936 to 1940, and the gross income of the G. & A. in 1942 was 3% of the System gross income, the G. & A. division would have received 3% of all the junior securities allocated on the basis of segregated earnings. It is estimated that

this would amount to approximately an additional $780,000 in income bonds, $150,000 preferred stock and $850,000 in common stock for the G. & A. division.

It is likewise clear that the only distribution of junior securities made to the socalled "deficit divisions" were based solely upon their traffic contributions (in a low average year) and their physical value. The socalled "deficit divisions" (which included the G. & A. division) as they had no segregated earnings in the period employed, did not share in the junior securities which were distributed upon the segregated earnings basis. The probability that they would have earnings in better years was not reflected nor was there reflected the fact that in order to meet the interest and dividend payments required under junior securities the level of earnings for the socalled deficit lines would have to be much greater than that which existed in 1936 to 1940, in which event it follows they would no longer be deficit lines and hence entitled to a much more equitable distribution.

It will be seen that the erroneous principle applied by the District Court and Circuit Court of Appeals (Vol. III, pp. 33-34) for the distribution of junior securities has greatly prejudiced the G. & A. bondholders and that they would have received substantial amounts of additional junior securities had the proper level of segregation earnings been applied.

In any event the method or principle applied for the distribution of junior securities by the courts below is in conflict with the applicable decisions of this Court and for that reason should be reviewed and reversed. (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pac. R. R. Co., supra.*)

POINT V.

The Circuit Court of Appeals erred in approving the allocation made to the Georgia and Alabama bondholders under the Plan of Reorganization where the District Court and Special Master failed to consider or apply the segregation formula adopted to the recent earnings in the years 1941 to 1943. The resulting allocations were obsolete and violated Section 77, subdivision (e) of the Bankruptcy Act.

Section 77 subdivision (e) of the Bankruptcy Act provides:

> "The value of any property used in railroad operation shall be determined on a basis which shall give due consideration to the earning power of the property, *past, present,* and *prospective* and all other relevant facts." (Italics supplied.)

The Primary Allocation made under the "Kennedy Segregation Formula" adopted by the Master is based on the earnings of the synthetic average of several years, 1936 to 1940, inclusive (Vol. I, Ct. Tr., 271-272). The earnings for these years were very low and several of these years used for the segregation yardstick by the Master both experts Wyer and Kennedy testified will not be repeated (Vol. I, Ct. Tr., 154-156, 196-199, 229, 387). In addition, Kennedy and Wyer testified that it was impossible to estimate what the future income or revenues of the Seaboard System will be, that the situation of the Seaboard Railway is always very changeable and that there are many variable factors which may and will affect its future income (Vol. I, Ct. Tr., 229, 387).

The Primary Allocation proposed by the Master and adopted by the Courts below is obsolete as the Master made no attempt to apply the segregation formula to the

years 1941, 1942 and 1943, and in reality he had no segregation studies of earnings for these years (1941, 1942, and 1943) to indicate the many changes in earnings position which factually had taken place among the various divisions; nor did the Master (because he had no studies for the years 1941 to 1943) compensate these divisions for their earnings for these years and for their contribution to the present cash position of the System (Vol. I, Ct. Tr., 222-224, 198-201, 276-277).

While it may be proper to use a period of low level earnings in order to establish a conservative and permissible capitalization which will prevent the return or necessity for any future reorganization, it is not necessary or fair to use this low lovel of earnings as a basis for determining the relative earning power of each of the various mortgage divisions of the System* (Vol. I, Ct. Tr., 197-201).

The principles set forth by Congress under Section 77 for establishing value in a railroad reorganization in bankruptcy are equally applicable to a reorganization in equity. It is clearly stated in Section 77 that to determine the value of any property, the earning power, *past, present and prospective,* must be considered.

The Master and Courts below omitted entirely and gave no consideration whatever to the immediate past and present earnings of the System (Vol. I, Ct. Tr., 222-224, 197-198).

Wyer's Court Exhibits No. 1 and No. 2 (Vol. I, pp. 409, 410) and his testimony (Vol. I, Ct. Tr., 157-162) which were not refuted, clearly proved that even assuming, *arguendo,* that the application of the Kennedy Formula adopted by the Master was correct in the first instance, that if the same formula was projected to the earnings for the year 1942, the net income for the G. & A. divi-

*See Swaine Article, Decade of Railroad Reorganization, under Section 77, *supra,* Harvard Law Review (July 1943).

sion was $1,016,937. Furthermore, on the same basis, the estimated earnings of the G. & A. Ry. for 1943 were $1,500,000 to $2,000,000.

These figures did not take into account, moreover, the adjustment in earnings which Wyer said should have been made in favor of the G. & A. Ry. in the sum of approximately $100,000 for (1) abandonment of the Albany Line; and (2) the passenger deficit charge which was improperly charged against the G. & A. Ry. (Vol. I, Ct. Tr., 218-222).

Furthermore, Wyer testified on cross-examination that as the earnings of the Georgia and Alabama Railway increased in the years 1942 and 1943, the contribution by the Georgia and Alabama Railway to the gross average revenue of the System likewise necessarily increased (Vol. I, Ct. Tr., 374-375). Considering that the Georgia and Alabama Railway contribution to the freight revenue of the System amounted to a net of $922,567 in 1939 when the Georgia and Alabama Railway purportedly had a deficit of $222,017 under the "Kennedy Segregation Formula", it must be recognized that the contribution by the Georgia and Alabama Railway to the freight revenues of the System in the years 1942 and 1943, when it admittedly had enormous earnings approximating $1,000,000 to $2,000,000, must have been considerably larger than the sum of $922,567 indicated for the year 1939. It will undoubtedly be argued that the earnings for the years 1941 to 1943 represent wartime earnings and should not be relied upon. In answer thereto, it must be noted that there is a great distinction between using wartime earnings as a base for establishing future earnings and the consideration of wartime earnings as actually earned; one is based *in futuro*, the other is an accomplished fact.

The District Court recognized and acknowledged this distinction (Vol. I, Ct. Tr. 325-327, 346-347).

Thus the fact that the Georgia and Alabama Railway earned, even on the basis of the "Kennedy Segregation

Formula", $1,016,937 in 1942 and approximately $1,500,000 to $2,000,000 in 1943, and in addition contributed enormously to the gross average revenue of the System in these years, was not considered or reflected in any manner by the Master in his allocation of securities or formula which unquestionably affected the final allocation to the Georgia and Alabama Railway Division very substantially.

Hence it is contended that the Plan of Reorganization approved by the Courts below, which adopted the Allocations and Segregation Formula proposed by the Master is erroneous and inequitable to the Georgia and Alabama bondholders.

POINT VI.

The approved Plan of Reorganization is erroneous in that it fails to compensate the bondholders of the Georgia and Alabama Railway for the full amount of their claim and in that it allocates to said bondholders greatly inferior and junior securities in exchange for their first mortgage bonds.

The Plan of Reorganization allocates to each G. & A. bondholder First Mortgage Bonds in the sum of $58.74; Income Bonds in the sum of $262.55; Preferred Stock in the sum of $107.88 and Common Stock in the sum of $614.61; making a total in the sum of $1,043.78. The total claim, including interest to January 1, 1944 per $1,000 bond of principal of each G. & A. bond is $1,625.

It is seen from the foregoing that the only senior security offered to the G. & A. bondholders are First Mortgage Bonds in the sum of $58.74 for each $1,000 bond. Assuming that the Income Mortgage Bond is a senior security, which it admittedly is not, the total amount of the First Mortgage and Income Bonds is $321.29. The balance of the securities offered are stocks which are greatly inferior and junior securities.

The Plan makes no attempt to compensate the G. & A. bondholders for their loss of their first mortgage position which is unquestionably of great value to them. In addition, the securities allocated to the bondholders are *much less* than the face amount of their claims and composed mostly of stock subject to a vast amount of prior liens. This was due to the principles of allocation adopted which determined the quantitative participation of the several mortgage divisions in the several classes of new securities which had to be allocated.

In allocating the new securities to the several divisions, the Master and Courts below proceeded on the following principle: In the Primary Allocation, all of the First Mortgage Bonds, one-half of all the Income Bonds and one-third of all the Preferred and Common Stock, were allocated on the basis of the average segregated earnings in the five-year period 1936 to 1940. 50% of the Income Bonds and 33-1/3% of the Preferred and Common Stock were allocated on the basis of the net value of freight contributions made by the several divisions to the System—33-1/3% of all the Preferred and Common Stock were allocated on the basis of reconstruction cost—new, less depreciation of the several mortgage divisions. In the Secondary Allocation, *all* of the securities were allocated on a basis of segregated earnings indicated for each mortgage division in the period 1936 to 1940.

It must be noted that all of the divisions, even those showing segregated earnings, participate in the distribution of Income Bonds and Stock distributed on the basis of net value of freight contributions. It must likewise be noted that all of the divisions, including those which showed segregated earnings, participated in the distribution of Preferred and Common Stock distributed on the basis of reconstruction costs new, less depreciation.

Let us analyze the effect of this principle of allocating all of the First Mortgage Bonds, 50% of the Income Bonds

and one-third of the Preferred and Common Stock *only* to the mortgage divisions which showed segregated earnings.

All of the First Mortgage Bonds were distributed only to those mortgage divisions which show segregated earnings. Then 50% of all the Income Bonds distributed were likewise distributed to the very same "earning divisions". Then one-third of all the Preferred and Common Stock were also distributed to the same "earning divisions". In effect, payment upon payment upon payment were made to the very same "earning divisions" without receiving in turn any credit for a previous payment. In addition, these very same divisions participated in the distribution of Income Bonds which were distributed on the basis of net value of freight contribution and also participated in the distribution of one-third of the Preferred and Common Stock which were allocated on the basis of reconstruction costs new, less depreciation. These pyramided payments were taken from the bondholders represented by the petitioning-appellants and other mortgage divisions who were entitled to share in them.

Obviously certain divisions received *over-favorable* treatment under the Master's Plan. This was objected to by the District Court as constituting a "bonus". Thus the Carolina Central Railroad Company Division, whose principal and interest aggregated as of January 4, 1944, $4,017,620, received a total par value of new securities in the sum of $10,285,526 consisting of the following: First Mortgage Bonds, $1,595,562; Income Mortgage Bonds $3,207,438; Preferred Stock $1,064,188; and Common Stock $4,418,340, more than six million dollars in excess of their total claim. The District Court in its opinion stated that this defect was remedied by the Compromise Committee by the process of "commutation" which substituted for the larger face amount of junior securities, *senior* securities of an equivalent value but smaller

face amount so that no mortgage division received more than the principal and interest of its whole claim in new securities at par.

However, the process of "commutation" does not cure the defect, it merely *conceals* the defect. The mortgage division which received the surplus of new securities did not surrender them but exchanged them for superior senior securities in a smaller face amount. Hence it obtained senior securities far in excess of the relative amount it should have received in the first instance. The excess so received must necessarily have been taken from the other mortgage divisions who are entitled to share them.

Thus "segregated earnings" under the processes and principles adopted by the Courts below were given so much weight that the resulting distribution was entirely out of proportion to the actual value of these Mortgage Divisions and their *relative value* in respect to the entire System.

The chart annexed to the District Court's Opinion showing the final allocation of new securities as of January 1, 1944, indicated that the G. & A. Ry. received the poorest treatment per bond of all of the underlying mortgages (Vol. I, p. 426). Even the South Bend which is practically a passenger line entirely, and of far *less value* to the *System* than the G. & A. Ry., receives securities in the face amount of $1,302.17, per bond, as compared with the $1,043.78 for the G. & A. bondholders. All of the other underlying divisional liens receive securities practically of the same par value as the total amount of their claim in addition to *superior* securities.

It is submitted that just as it was improper for the Master to give to the Carolina Central and the Florida Central and Peninsular par value securities far exceeding the total amount of their claim, so is it similarly erroneous to give the G. & A. bondholders par value securities far less than the face amount of their claim which, in ad-

dition, are mainly composed of junior securities or stock.

"The rule of absolute priority" is irrebuttably established in two recent Supreme Court cases:

> *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939); and
> *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941).

In the *Consolidated Rock Products case*, 312 U. S. 510, 528 *et seq.*, the Court said that bondholders must be *"made whole"*. Their loss of their former senior fixed charge position through allotment of *"an inferior grade of securities"* necessitates that *"full compensatory* provision * * * be made for the entire bundle of rights which the creditors surrender". For surrendering senior rights, creditors must receive *"full compensatory treatment"*. They are entitled to have the *"full value of the property*, whether *present* or *prospective*, for dividends or only for purposes of control first appropriated to payment of their claims." (Italics supplied.)

That the treatment is unfair and inequitable is further illustrated by the net salvage value of the G. & A. Ry. One cannot compare the value of a railroad as junk or scrap value with the same railroad as a going operating business. Yet the Receivers of the Seaboard, as shown by their Special Master's Exh. 517 (Vol. I, 607) fixed the net salvage value of the G. & A. Ry. at $1,200,000 *exclusive* of rights of way whereas the total *value* of all the securities received by the G. & A. Ry. is estimated to amount to $1,792,106.

It is apparent from the foregoing that the allocation given to the G. & A. Ry. bondholders under the Plan of Reorganization is clearly erroneous, in violation of the laws of the land and should not be sustained in any Court of Equity.

POINT VII.

The Segregation Formula adopted for the purpose of determining the earnings of each Mortgage Division and the resulting allocation of new securities is predicated upon false and artificial assumptions and hence is erroneous and inequitable.

The basic distribution of new securities in the approved Plan of Reorganization between the several classes of mortgagees, having claims of equal rank against different assets of the Seaboard System, is predicated upon three allocations, known as Primary, Secondary and Tertiary Allocations.

The Segregation Formula adopted by the Courts below, to determine the earnings of each of the mortgage divisions, is of *primary* importance since the segregated earnings of each mortgage division, in effect, establishes the *relative value* of that division to the System. The Secondary Allocation is predicated *entirely* upon the segregated earnings of each division under the Formula adopted; and the Primary Allocation was derived principally from the Segregation Formula since all of the First Mortgage Bonds, one-half of all the Income Bonds and one-third of all the Preferred and Common Stock is distributable solely on the segregated earnings indicated in the period 1936 to 1940 (Vol. III, pp. 27-29, Cir. Ct. Op.).

The Segregation Formula adopted by the Courts below was the *yardstick* employed to determine the expenses and revenues attributable to each of the Railroad Mortgage Divisions in order to ascertain the net earnings of each of the mortgage properties. Many of the mortgage divisions of the System under the "Kennedy Segregation Formula" showed *no* net segregated earnings and were designated as "deficit lines" (Vol. I, Dist. Ct. Op., 108).

Distribution Under "Segregation Formula" to G. & A. Ry.

The adopted "Kennedy Formula" stated that the G. & A. Ry. income in the average year for the period 1936 to 1940 is a deficit in the sum of $222,017 after all adjustments (Vol. II, Table 2, S. M. Rep.).

Under the "Kennedy Segregation Formula", the G. & A. Ry. received no First Mortgage Bonds as it had no segregated earnings. In view of the net value of its freight contributions, it received Income Mortgage Bonds in the sum of $1,599,640; Preferred Stock in the sum of $373,903 and Common Stock in the sum of $2,129,517. The estimated cost of the reproduction new, less depreciation as of December 31, 1941 is $7,886,829. Based on this valuation, the G. & A. Ry. was allotted Pfd. Stock in the sum of $285,894 and Com. Stock in the sum of $1,619,231.

The Master's *total* Primary Allocation to the G. & A. Ry. was $1,599,640 in Income Bonds, $659,797 Pfd. Stock and $3,748,748 Com. Stock. The G. & A. Ry. received no securities under the Secondary Allocation as it showed no segregated earnings.

Definition and Purpose of a Segregation Formula.

There are many segregation formulas (Vol. II, S. M. Rep. 214-226). A segregation formula attempts to allocate to the various divisions of the system the earnings and expenses reasonably attributable to each mortgage division or segment of the system. A segregation formula purports to ascertain, by these means, the net earnings of each segment in order to establish the relative value of each mortgage division to the railroad system (Vol. II, S. M. Rep. 214-226).

However, the term "segregation" as employed is not used in its usual legal sense to wit: that the item segregated is distinctly identifiable or distinguishable on its face. As employed herein, "segregation" is in reality

synonymous with the term "allocation" (Vol. I, S. M. Tr., 471-472, 475-476). In order to segregate the revenue and expenses attributed to the various divisions, certain arbitrary and artificial assumptions must be adopted (Vol. I, S. M. Tr., 437-446). The purported segregation earnings, therefore, derived from the use of the formula are dependent upon these assumptions and have no greater validity than the artificial and arbitrary basis upon which they are predicated (Vol. I, S. M. Tr., 437-446).

Problem.

The real problem is how to fairly determine what should be the proportionate shares of each of the several divisions, all of which are first liens of equal rank, in the several classes of new securities to be issued.

In principle, the various creditors of the insolvent Corporation should receive in the new securities to be issued of the proposed Corporation, the *equitable positional equivalent* each formerly possessed.

In discussing the same problem in the "Milwaukee" case (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pac. R. R. Co.*), 318 U. S. 561, 563, Mr. Justice Douglas said:

> "* * * But where, as here, each group of bondholders is contributing to a new system mortgage separate properties from old divisional mortgages, it is necessary to fit each into the hierarchy of the new capital structure in such a way that each will retain in respect to the other the same position it formerly had in respect of assets and of earnings at various levels. If that is done, each has obtained new securities which are the equitable equivalent of its previous rights, and the full priority rule of the *Boyd* case, as applied to the rights of creditors *inter se*, is satisfied. * * *"

In order to determine the equitable equivalent it is necessary to ascertain the *relative value* of each of the mortgage divisions.

Sub-section (e) of Sec. 77 of the Federal Bankruptcy Act provides:

> "The value of any property used in railroad operation shall be determined on a basis which shall give due consideration to the earning power of the property past, present and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land in the light of its earning power and all other relevant facts."

However, as stated by Mr. Justice Brandeis in the case of *Southwestern Bell Telephone Company* v. *Public Service Commission*, 262 U. S. 276, 310, "Value is a word of many meanings".

Mr. Justice Douglas in the *Milwaukee* case, *supra*, said:

> "It covers its meaning in a particular situation from the purposes of which a valuation is being made. Thus the question in the valuation for rate making is how much a utility will be allowed to earn. The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn."

In resolving the problem of *permissible capitalization* of a reorganized company, earning power was the primary test in equity receivership proceedings as well as any former railroad reorganizations.

In the "*Milwaukee* case", *supra*, in discussing the *permissible capitalization*, this Court said:

> "The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn. Earning power was the primary test in former railroad reorganizations under equity receivership proceedings. *Temmer* v. *Denver Tramway Co.*, 18 F. 2d 226, 229; *New York Trust Co.* v. *Continental & Commercial Bank*, 26 F. 2d 872, 874. The reasons why it is an appropriate test are apparent. A basic requirement of any reorganization is the determination of a capitalization which makes it possible not only to respect the priorities of the various classes of claimants but also to give the new company a reasonable prospect for survival. * * * Certainly there is no constitutional reason why earning power may not be utilized as a criterion for determining values for reorganization purposes. And it is our view that Congress when it passed Section 77 made earning power the primary criterion."

Although earning power seems to be the only and primary test or basis for *ascertaining permissible capitalization*, it does not necessarily follow that this is true for the ascertainment of the relative values of various separate mortgaged properties of a railroad system. This was likewise observed by Judge Chesnut (Vol. I, Ct. Tr., 260-263, 265, 293-295). Mr. Warner, testifying before the Master, expressed it as follows:

> "A well rounded railroad system is a thing of many parts each of which has its distinctive functions or purposes and the question of the relative value of each to the whole hinges on its contribu-

tion to system results. Merely because some of these are less susceptible to mathematical evaluation does not make them any the less real. Mr. Kennedy expressed it well where at page 1121 of the record, he stated that:

> 'There are all kinds of different elements of value that a mortgage line can have to a system. It may have heavy earnings on the traffic it carries; it may have a high strategic value in its access to important industries or other important sources of traffic; it may contribute a great deal of traffic to the remainder of the system. All those things enter into the determination of the value of a mortgage line and its value relative to the other lines in reorganization'" (Vol. I, S. M. Tr., 464-465).

The Master attempted to ascertain the actual earnings of each of the mortgaged properties during a certain period (1936-1940), through the use of the "Kennedy Segregation Formula" which he adopted. This formula endeavored to *separate* each of the mortgaged properties and treat each division as if it were a separate operating railroad, and then allocated to each division certain expenses and revenues of the System in order to ascertain the net earnings of each division. After thus ascertaining the purported net earnings of the various divisions the Master allocated to the various divisions, based upon their relative percentages of the so-called "segregated earnings", all of the new first mortgage bonds, one-half of the income bonds and one-third of all the preferred and common stock. However, based on the so-called "segregation" formula, certain of the mortgage divisions, including the G. & A. Ry. had *deficits*, instead of net earnings and did not share in the Primary Allocation of the first mortgage bonds, income bonds and stock which

were distributed solely on the basis of segregated earnings (Dist. Ct. Op., p. 108). This was likewise true of the Secondary Allocation.

The fairness of any formula must be judged by the results of its application. This is particularly true in the case of a railroad inasmuch as the facts in respect to any railroad system are so different, varied and complex (Vol. I, Dist Ct. Tr., 200; Vol. I, S. M. Tr., 437-460).

As stated by the District Court in its opinion (Vol. I, 109, 114):

> "There is no uniformly recognized yardstick for the calculation of the net earnings of separate Divisions of a unified railroad system. * * * It must be remembered here that there is no rule of law which prescribed the criteria for the determination of earnings of separate railroad divisions in one system."

In the *"Milwaukee"* case, *supra*, Mr. Justice Douglas said (p. 563):

> "The problem in such a case is not a simple one. The contribution which each division makes to a system is not a mere matter of arithmetical computation. It involves the appraisal of many factors and the exercise of an informed judgment. Furthermore, an attempt to put precise dollar values on separate divisions of one operating unit would be quite illusory. As the Commission recently stated: 'The properties comprise one operating unit; a complete separation of values would necessarily have to be based on extensive assumptions of unprovable validity; and any attempt at such a separation would in the end serve no purpose except to present an apparent certainty in the formu-

lation of the plan which does not exist in fact'."
* * *

Nevertheless, the "Segregation Formula" adopted by the Master and Courts below has in effect, endeavored to do the very thing which this Court and the Interstate Commerce Commission said *could not be done*. Furthermore, the unfairness of the results of the "Kennedy Segregation Formula" is recognized and admitted in fact by the Master at pages 246, 247 of his Report (Voll. II) when he states:

> "It should be remembered that each of the lines upon which the deficit occur upon any of segregation formulae is a part of the integrated system. It is readily conceivable that the method of determining value of the segregation might operate unjustly against portions of the system and reflect a loss, unless regard is had to many other elements of value which are present and make their contribution to the success of the entire operation. The apparent loss might result from circumstances, none of which should necessarily occasion a penalty when the contribution to the joint enterprise is properly evaluated. * * * Strictly speaking, the term deficit line is a misnomer and its treatment as such in the final analysis implies a criticism of the system management, for the obvious step in the case of any portion of the property which *per se* is not paying its way directly or indirectly, is abandonment. It is therefore concluded and it is so found that any line that is comprised within a Plan of Reorganization as herein recommended will be accorded such treatment in the allocation of securities as the elements of value possessed by it may warrant even though under the segregation formula it fails to disclose earnings."

Nevertheless, in his allocation of new securities, the Master allocated *all* the first mortgage bonds, *50%* of the Income Bonds and *one-third* of all the Preferred and Common Stock *solely* on the basis of segregated earnings made by each mortgage division in the period 1936 to 1940, and made no variation therefrom.

In addition, his Secondary allocation which redistributes most of the securities released by the Receivers purchases which amounted to $34,000,000 (see Point 3 of Brief) is also predicated *solely* upon segregated earnings and distributed only to those mortgage divisions which showed segregated earnings in 1936 to 1940.

How Does One Ascertain the True Earning Power of Separate Mortgage Properties Which Comprise One System Operated as a Unit?

In considering the relative value of each divisional property, the yardstick which seems to have been adopted by the Master and the Courts below is the *earning power* of the mortgaged property. In trying to measure the earning power of each of the various divisions, they adopted a yardstick known as the "Kennedy Segregation Formula", which purported to treat each divisional mortgaged property as a separate operating railroad, allocating through the use of the particular formula, the various expenses and revenues of the System to each of these divisions and thereby ascertaining the purported net earnings of each division in the years selected.

It is clear that if one is seeking to measure the earning power of a segment or division of a railroad system, the important element is not what each individual division earns, as if it were presumably operating by itself, but what the *System actually earns* through the operation of each mortgage division as part of the System; that, in reality, represents the earning power of that particular

mortgage division. As Col. Anderson, one of the Receivers expresses it:

> "If a railroad is to be dealt with as a whole and each mortgage division within that system is to be given equitable treatment in reorganization, it is manifest that the problem involved is not the ascertainment of the earning power and value of each mortgage division as a separate railroad but is the ascertainment of the relative earning power and value of each mortgage division in its relation to all other mortgage divisions in a system operated as a unit" (Vol. I, S. M. Tr., 446).

Basic Fallacy of the Adopted Segregation Formula.

The "Kennedy Segregation Formula" is based upon the false and artificial assumption that each mortgage division is operating as a separate railroad. That is contrary to the facts. The System before the receivership and during the receivership has been operated as a whole. Each mortgage division is dependent upon other mortgage divisions for the origination, handling and termination of freight moving over more than one mortgage division. The revenues of all divisions are taken into a common treasury and the expenses of operating all divisions, whether assigned segregated revenues are adequate or not, are paid out of the common treasury (Vol. I, S. M. Tr., pp. 438-440, 462-463).

In addition, the segregation formula artificially and arbitrarily assumed numerous special allowances or arbitraries to compensate in whole or in part for the assumed cost of origination and termination of business, terminal expenses etc. These assumptions are entirely unrealistic and mostly *guess work*. Under the segregation formulas, if a deficit line could not meet its expenses, the System

nevertheless, paid it, whereas in truth and in fact, if a mortgage division was unprofitable and a loss to the System, that mortgage division or line would be *abandoned* (Vol. I, S. M. Tr., pp. 462-463; Vol. II, S. M. Rep. 246-247). The effort of the "Kennedy Segregation Formula" to treat each mortgage division as a separate operating railroad therefore, in the distribution of earnings and expenses is based upon assumptions which are contrary to the facts of the situation and wholly unrealistic (Vol. I, S. M. Tr., pp. 438-440, 462-463; Vol. I, Ct. Tr., pp. 234-243).

While theoretically the mortgagee is entitled to a foreclosure of the mortgage and to enforce the rights thereunder, this is not the case under the present law. The Courts have held that the *public* interest in railroads is dominant. To the extent required by public interest, a railroad must be operated as a unit and sold as a unit when foreclosed. No railroad or a part of the railroad can under existing law be sold or transferred to a purchaser except with the approval of the I. C. C. Obviously, the Commission could not find that the sale of mortgage divisions separately, is in the public interest. Therefore, the several mortgage divisions cannot be segregated from the System, but must be reorganized as a whole. This conclusion is necessary both under the Interstate Commerce Act and Section 77 of the Bankruptcy Act which in effect, suspends the right of foreclosure and provides for the reorganization of the system as a system (Vol. I, S. M. Tr., pp. 440-441)

Viewed properly, the real inquiry in any reorganization of a railroad system under the existing law is as to the *relative value* of each of the several mortgage divisions *as a part of the System*, not individually as a separate operating railroad. The relative extent to which the System does benefit or earn income by the use and operation of each of the mortgage divisions in effect,

establishes the relative value of the several mortgage divisions in relation to each other.

The complete unfairness of the "Kennedy Formula" and its results is illustrated forcibly by S. M. Exh. 415 (Vol. I, 591) introduced by the expert, Wyer, which shows the contributions in 1939 of each of the mortgage lines to the System's gross income from freight traffic under the "Wyer Formula". (The results under the "Wyer Formula" for the G. & A. Ry. are poorer than under the "Kennedy Formula".) 1939 was one of the poorest years from the standpoint of the G. & A. Ry., yet this Exhibit 415 shows that the G. & A. division contributed to the balance of the System the sum of $1,248,660 in freight revenues and that the balance of the System contributed to the G. & A. line in turn the sum of $326,099, leaving a net contribution by the G. & A. division to the System in the sum of $922,567, or 13.10% of the *total* annual net income derived by the System from freight traffic. As the history of Seaboard has shown, it is an acknowledged fact that the only profitable revenue obtained in the System is that obtained through freight traffic and not passenger traffic which has always been conducted at a great loss (except in the recent war years) (Vol. I, Ct. Tr., pp. 219-222).

Yet under the adopted Master's "Segregation Formula", the G. & A. Ry. is designated as a deficit line with no earnings, but a purported deficit in the sum of $220,107. The unfairness of the Master's "Segregation Formula" was further emphasized by Wyer's testimony (Vol. I, Ct. Tr., 157-164) and Wyer's Ct. Exh. No. 1 (Vol. I, 409) which clearly proved, even assuming the Master's Formula to be correct in the first instance, that if the Segregation Formula were projected to the year 1942, the net railway operating income for the G. & A. Ry. in 1942 was $1,016,137, and that on the same basis the estimated earnings of the

G. & A. Ry. for the year 1943 were $1,500,000 to $2,000,000. Furthermore, these figures are based upon the "Kennedy Segregation Formula" which do not properly reflect in the first instance the true earnings or value of the G. & A. Ry. In addition, the above figures do not take into account the adjustments which Wyer testified should have been made for the G. & A. Ry. in the approximate amount of $100,000 for (1) the abandonment of the Albany Branch and (2) the unfair passenger deficit charged against the G. & A. Ry. (Vol. Ct. Tr., pp. 218-222).

The unfairness of the Master's Plan in predicating his allocations primarily on the Kennedy Segregation Formula, which resulted in setting a valuation of $1,433,463 for the G. & A. Ry. is also strongly indicated by the fact that the estimated *salvage value* of this line approximates this sum, since the Receivers in their statement dated March 5, 1942 (S. M. Exh. 517; Vol. I, 607), found the estimated gross salvage value of the G. & A. Ry. to be approximately $1,200,000 *exclusive* of all rights of way.

The basic fallacy of the "Kennedy Formula" and the other proposed segregation formulas was recognized by both of the Receivers of the System. This fallacy consisted of the fact, that in reality, there *was no deficit* mortgage division; that the so-called earning lines were entirely dependent upon the so-called deficit lines for their purported earnings and that their earnings under the segregation formula were due in great part to the contributions of the so-called deficit lines (Vol. I, S. M. Tr., pp. 462-463, 438-460; Ct. Tr., pp. 234-243). The Receivers testified both before the Master and the District Court at their request. The Receivers endeavored at all times to be impartial and had no personal interest in the segregation formula adopted.

Col. Anderson, one of the Receivers, pointed out the basic *fallacy* of the segregation formula adopted, was that

it was predicated on an assumption entirely contrary to the facts, to wit, that each of the mortgage railroad divisions was a separate operating railroad (Vol. I, S. M. Tr., pp. 438-441). He indicated that the effect of the application of the segregation formula was to reward or enrich the so-called central or bridge lines which were usually low level lines which originated and terminated very little traffic (Vol. I, Ct. Tr., pp. 239-242; S. M. Tr., pp. 438-441). That the divisions or lines which tapped the sources of the business carried by the System and from which most of the freight originated or terminated, were generally steep grade divisions whose terminal costs were very high in comparison with the other division lines and whose operating costs also were much higher than the central or bridge lines. As he expressed it, if there were three mortgage divisions, and two of the divisions passed through mountainous territory but originated and terminated practically all of freight carried on the railroad system, and these two divisions were connected by the third division which was a low-level and low operating cost line, the application of the Kennedy, Wyer or General Formulas would result in the two mountainous divisions, being designated as *deficit lines* and the central or bridge line would be ascribed as the only earning division of the three. Although in reality the central or bridge line in itself was worthless without the other two steep grade originating and terminating divisions, which procured practically all of the business of the System. The System was operated on a profitable basis as a whole, but if one applied any segregation formula as proposed in the instant case, only one division would show any earnings, to wit, the central low-level division and the other divisions which were equally important and indispensable would be designated as deficit divisions and receive no portion of the new securities allocated solely on the basis of segregated earnings.

In contradistinction the Receivers recognized that the important element was not what each division earned separately, as if it were operated separately, but what the *System* or unit as a whole *earned* through the use and operation of each of the various mortgage line divisions and they sought to find the relative values of the several mortgage divisions by estimating the relative contribution of each of the divisions in the final or net earnings of the railway *System* as a whole. They realized that it was ridiculous to say that a division was a non-earning or deficit division, when it was only through the use or operation of that division that a substantial portion of the System's revenues were derived (Vol. I, S. M. Tr., pp. 462-463; Ct. Tr., pp. 239-242). They recognized the inequity of allocating the major portion of securities to be issued, solely upon the basis of so-called segregated earnings but nevertheless continue to operate and use this so-called deficit mortgage division without rendering in turn any compensation whatever for this use to the mortgagees or owners thereof (Vol. I, S. M. Tr., p. 443).

It appears the basic fallacy of the "Kennedy Segregation Formula" is its reliance solely on the assumed earnings of each mortgage division as if each were operated as a separate railroad without considering in any wise the respective contribution made by each division to the System's earnings as a whole (Wyer, S. M. Exh. 415; Vol. I, 591).

To illustrate this clearly, let us assume that a large railroad had the following two mortgage divisions. One division, on the basis of the "Kennedy Segregation Formula", was a good earning line earning for its own division $300,000 a year, but contributing practically no traffic or earnings to the balance of the System as a whole, outside of its individual earnings of $300,000 a year. Let us assume on the other hand, that in the other division we have a so-called "deficit" line which has a deficit of

$200,000 a year as measured by the segregation formula, but nevertheless, this second mortgage division contributed to the net earnings of the entire System $1,000,000 per year; its net contribution to the System, after deducting its deficit of $200,000 per year is $800,000 (this is actually the case with respect to the G. & A. Ry; see S. M. Exh. 415; Vol. I, 591). Let us assume a choice has to be made by the System as to which division it may keep; the System has to decide to abandon one of the mortgage divisions, it cannot keep both.

It is submitted that there cannot be any question, as a matter of pure business judgment, that if there is a so-called deficit division that earns *for the System* a net of $800,000 per year, and on the other hand, this other division which nets on the basis of its own earnings $300,000 per year, but contributes nothing else to the income of the System, the choice would be very plain. The System would still take the so-called deficit line because the System will earn a net of $800,000 on that line per year (Vol. I, Ct. Tr., pp. 309-313, 368-375). The relative value of the so-called "deficit" division *to the System* would be much greater than the so-called "earning" division.

It is clear, if one seeks to ascertain the actual earnings or relative value of each mortgage division as part of a System, that the approach or point of view of the "Kennedy Segregation Formula" is basically wrong. To ascertain the earnings or respective contribution of each of the several mortgage divisions, the only correct method is to ascertain what portion of the earnings of the *System as a whole* were contributed by each of the mortgage divisions. It necessarily follows that the true earning power and relative value of each mortgage division to the System as a whole can be found by not only ascertaining its individual earnings, but by also ascertaining its respective contribution to the System income

as a whole. The sum total of these two figures will actually represent the *total contribution* of each mortgage division to the net income or earnings of the System as a whole and likewise represent its relative value.

CONCLUSION.

It is therefore respectfully submitted that this case is one calling for the exercise by this court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Respectfully submitted,

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Counsel for Petitioners, F. G. Badenhausen, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Consolidated Mortgage.

HARRY O. LEVIN,
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(10)

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CHARLES ELMORE CROPL

Supreme Court of the United States

OCTOBER TERM, 1944

No. 720

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

against

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, *et al.*, Complainants, v. Seaboard Air Line Railway Company, *et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

BRIEF IN OPPOSITION TO PETITON FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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OCTOBER TERM, 1944

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BRIEF IN OPPOSITION TO PETITON FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

Opinions Below

The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is reported in 145 Fed. (2d), at page 40. It is printed at R. Vol. III, pp. 9-39.

The opinion of the United States District Court for the Eastern District of Virginia is reported in 53 Fed. Supp., at page 672. It is printed at R. Vol. I, pp. 81-147.

Jurisdiction

Petitioners invoke the jurisdiction of this Court under Section 240(a) of the Judicial Code (28 U. S. C., Section 347).

Brief Statement of Facts

Petitioners have presented none of the "special and important reasons" upon which this Court will grant review on writ of certiorari. They are asking this Court to consider whether the District Court in approving a plan of reorganization for Seaboard Air Line Railway Company (hereinafter called Seaboard) dealt fairly with the holders of bonds of Georgia & Alabama Railroad Company (hereinafter called the Georgia & Alabama Bonds). The Georgia & Alabama Bonds are one of ten underlying bond issues, each of which is secured by lien on a relatively small part of the properties of the Seaboard.

The total claims (as of January 1, 1944) of the securities to which allotments were made under the Seaboard Plan aggregated about $284,500,000. The total claim of the Georgia & Alabama Bonds was about $7,700,000, or about 2½% of the total (R. Vol. I, p. 80).

There are outstanding $6,185,000 of the Georgia & Alabama Bonds including $100,000 pledged as security under a lease. The affidavit filed by counsel for petitioners in the Circuit Court of Appeals (R. Vol. III, p. 6) indicates

that petitioners then claimed to represent about 10% of the Georgia & Alabama Bonds.*

The Seaboard has been in receivership since 1930. The Plan of Reorganization which the petitioners seek to have this Court review is the result of protracted hearings before a Special Master appointed in 1939 which covered a period of more than three years and subsequent hearings before Judge Chesnut, sitting for the United States District Court in the Eastern District of Virginia (hereinafter called the Virginia Court), and Judge Akerman, sitting in the United States District Court for the Southern District of Florida (hereinafter called the Florida Court), which lasted for several weeks.†

No appeals were taken from the orders of the Virginia Court and the Florida Court approving the Plan except by these petitioners and by one other individual owning a small amount of another issue of underlying bonds.

Parts of the property of the Seaboard are subject to the respective first liens of ten underlying mortgages, one of which is the mortgage securing the Georgia & Alabama Bonds. There were also involved in the reorganization three

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*The so-called "Underlying Committee" referred to in the petitioner's brief has approved the Plan, including the treatment of the Georgia & Alabama Bonds. A total of $4,112,000 of the Georgia & Alabama Bonds (or 68% of the entire issue, excluding the pledged bonds) has become subject to the Plan either by deposit with the Underlying Committee or by deposit with the Reorganization Committee.

†Judge Chesnut and Judge Akerman sat together for the purpose of expediting the proceedings. After the hearings the Virginia Court entered an order approving the Plan and wrote an opinion. The Florida Court (being the ancillary Court) entered a confirmatory order but did not write an opinion. The appeal to the Circuit Court of Appeals for the Fourth Circuit involved, of course, only the order and opinion of the Virginia Court.

issues of general mortgage bonds, two collateral trust issues, and five issues of bonds secured by first liens on lines of railroad leased to the Seaboard.

The basic problems in the reorganization were (a) to determine a capitalization of the reorganized company consistent with the public interest and in accordance with the principles adopted by the Interstate Commerce Commission in the reorganizations under Section 77 of the Bankruptcy Act and (b) to determine the relative values of the different properties on which the several mortgages constituted liens, so that the authorized capitalizatic could be equitably distributed.

The capitalization fixed by the Special Master and approved by the Courts was $196,870,000 (R. Vol. III, p. 13), an amount substantially less than the total outstanding debt of the Seaboard (R. Vol. III, p. 12). That capitalization has been approved by the Interstate Commerce Commission. A copy of the Commission's Report dated August 12, 1944 in Finance Docket No. 14500, is annexed as Schedule A. Petitioners do not urge that capitalization should be increased.

In a few cases the properties subject to the underlying mortgages were found to have a value for reorganization purposes exceeding the total claim of the underlying bonds secured by first lien thereon. In those cases the securities representing such excess value were distributed to the general mortgage having the next junior lien on those properties. In the case of the property securing the Georgia & Alabama Bonds, however, the Special Master found, and the District Courts agreed, that the value of that property for reorganization purposes was less than the claims of the holders of Georgia & Alabama Bonds. Accordingly, no new

securities were allotted to anyone other than the holders of the Georgia & Alabama Bonds in respect of the property securing those bonds. The Georgia & Alabama lines were "deficit lines" that is, lines which showed no earnings available for interest under the segregation formula for periods prior to the war.

The testimony at the hearing before the Courts was to the effect that the Seaboard would not lose any material amount of business if the Georgia & Alabama were not a part of the System and that the Georgia & Alabama would not be "economically justified as a separate independent railroad there by itself."

Petitioners came into this case at a late stage of its development. They did not appear at the hearings before the Special Master. They appeared at the hearings before the Courts in October, 1943, but they did not offer any evidence at those hearings although given full opportunity to do so. It has been admitted by their counsel at hearings in these proceedings that substantially all of the bonds represented by the petitioners were acquired by their present owners after the hearings before the Special Master had been completed.

The statement of facts contained in the petition contains certain misstatements of fact, some of which are as follows:

1. Petitioners repeatedly state that the so-called "Compromise Committee" purported to act in a "judicial" capacity. The record shows that that statement is unfounded. It shows (R. Vol. I, p. 414) that they "have considered themselves to be in the position of officers of the courts." The Committee had no authority except to confer with the parties and make recommendations to the

Courts. The true nature of its duties and powers is indicated by the fact that both the District Court and the Circuit Court in their opinions refer to the Committee as a "Conference Committee". The opinion of the Circuit Court of Appeals describes the functions of the Committee as follows (R. Vol. III, p. 11):

> "In the interval between the second and third sessions a Conference Committee appointed by the Court considered the testimony that has been offered, conferred with interested parties and recommended modifications of the Master's plan, which the Court approved."

The petitioners also state on page 6 of the petition that the Committee gave no reason for its recommendations. The report of the Committee and the exhibits filed in connection with that report (R. Vol. I, pp. 413 to 433) clearly set forth the reasons for the recommendations.

2. On page 7, and again on page 11, the petition states that the securities allotted to the Georgia & Alabama Bonds were "valued at" certain specified amounts. No dollar values were assigned by the District Court to any of the new securities.

3. The petition states on page 10:

> "It was recognized by the District Court and practically all of the parties in interest that these huge wartime earnings were entirely due to traffic contributed by the various underlying divisional lines and that all the underlying divisional lines were earning huge sums during the years 1942 and 1943, particularly those lines which * * * were denoted as 'deficit lines'."

The citations from the record which are cited as supporting that statement do not support it. There is no evidence what-

soever that the wartime earnings were entirely due to traffic contributed by the lines subject to the underlying divisional mortgages or that the "deficit lines," of which the Georgia & Alabama was one, showed an increase in earnings during the war years relatively as great as, or greater than, the increase shown by the lines which had been profitable prior to the war.

4. The petition states on page 16 that it became apparent that the Underlying Bondholders Committee (which represented the Georgia & Alabama Bonds and other underlying divisional mortgages) "favored the so-called 'earning divisions' represented by it." No record citations are given to support that statement and even a casual examination of the record will show that it can not be supported. In fact the Underlying Committee made most earnest and serious efforts throughout the proceedings to improve the position of the weaker underlying issues (the deficit lines) at the expense of the general mortgage issues secured primarily by second liens on the profitable underlying divisions.

These petitioners presented no evidence before the District Courts. They relied entirely on the evidence presented by the Underlying Committee. They made no arguments before the District Courts on behalf of the Georgia & Alabama Bonds other than arguments which had been made or were then being made by Mr. France as counsel for the Underlying Committee or by the Underlying Committee's expert, Mr. Wyer. Every contention made by these petitioners was also made by the Underlying Committee on behalf of the Georgia & Alabama and other "deficit lines."

5. The petition states (p. 10 and p. 37) that the Tertiary Allocation "applied to only a small portion of the new

securities released." The Tertiary Allocation was the allocation among all outstanding issues, on the basis of their estimated relative shares in 1942 and 1943 earnings, of certain First Mortgage Bonds which had been allocated under the Special Master's Plan to Receivers' Certificates subsequently paid, and certain cash and junior securities released by other modifications of the Special Master's Plan. In fact the Tertiary Allocation applied to nearly $2,000,000 of cash, nearly $10,000,000 of First Mortgage Bonds (almost one-third of the entire First Mortgage issue) and substantial amounts of junior securities. Of those reallocated securities the Georgia & Alabama Bonds received 3.087% (R. Vol. I, p. 411).* Petitioners do not claim that their contribution to wartime earnings exceeded 3%.

The Questions Sought to be Raised by the Petition

Petitioners enumerate eleven questions on which they base their request that this Court grant certiorari. Of the eleven questions all but the first four and the last one deal solely with the methods used by the Special Master and by the District Court in allocating new securities as among the several mortgage divisions of the Seaboard. Presumably, this Court will not concern itself with the details of methods used to determine the relative values of various sections of a railroad (see page 19, below).

The first question stated is based on an alleged conflict with the decision of the United States Circuit Court of

*The G&A Bonds received $361,018 of First Mortgage Bonds on the Tertiary Allocation (R., Vol. I, p. 80). Since their distribution ratio was 3.087%, it is clear that the aggregate amount of cash and First Mortgage Bonds distributed was the amount of which $357,408 is 3.087%, or about $11,700,000.

Appeals for the Second Circuit in *New England Coal & Coke Co.* v. *Rutland Railroad Co.*, 143 Fed. (2d) 179, (1944) on the question whether the Seaboard reorganization should be allowed to proceed in equity. There is no such conflict. The Circuit Court of Appeals for the Second Circuit in the *Rutland* case wrote a supplemental opinion on petition for rehearing, 143 Fed. (2d), 190, in which it expressly distinguished the Seaboard reorganization from the Rutland reorganization on the ground that the Seaboard receivership proceedings had started prior to 1933, when Section 77 became law, and were, therefore, not "irregularly instituted." (See p. 10, below). The opinion on rehearing is not mentioned in the petition herein, but it proves that the Second Circuit Court of Appeals itself considered that there was no conflict.

The second, third and fourth questions relate to the appointment by the District Courts of a Committee (referred to by the Courts as a "Conference" or "Compromise" Committee) to confer with the parties and to recommend for consideration by the Courts such modifications, if any, of the plan recommended by the Special Master as might be deemed fair and equitable. It is alleged by the petitioner that the appointment of the Compromise Committee "so far departed from the accepted and usual course of judicial proceedings * * * as to call for an exercise of this Court's power of supervision."

Petitioners did not object in the District Court proceedings to the appointment of the Committee or to the membership of the Committee, nor did they raise any question as to the propriety of the appointment of the Committee or its membership in their appeal to the Circuit Court of Appeals. They have waived any right to object at this

stage of the proceedings. In any event, the appointment of the Committee was entirely in accord with the usual reorganization procedure. (See p. 12, below).

The eleventh question presented by the petition is based on a claim that the Georgia & Alabama Bonds were not granted "compensation" for the loss of their first mortgage position, thus seeking to bring this case within the rule laid down by this Court in *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company,* 318 U. S. 523, (1943). No such question can arise in this case, since no part of the value assigned by the District Court to the property securing the Georgia & Alabama Bonds was given to any security holder other than the holders of the Georgia & Alabama Bonds. (See p. 17, below).

ARGUMENT

POINT I

There is no conflict between the decisions of the Circuit Court of Appeals in this case and the decision of the Circuit Court of Appeals for the Second Circuit in *New England Coal & Coke Company* v. *Rutland Railroad Company*.

In *New England Coal & Coke Company* v. *Rutland Railroad Company,* 143 Fed. (2d) 179 (1944), the Circuit Court of Appeals for the Second Circuit held that the reorganization of Rutland Railroad Company could not proceed in equity after a petition for reorganization of that Company under Section 77 of the Bankruptcy Act had been duly filed by persons entitled to file such a petition under

Section 77. In that case the petition under Section 77 was filed by the debtor corporation. In the opinion in that case Judge Frank stated by way of dictum that since the enactment of Section 77 a consent receivership in equity is "a means for the frustration of the public policy of the United States embodied in Section 77." The receivership proceedings against Rutland Railroad Company were instituted in 1938, five years after Section 77 became law.

On motion for rehearing in the *Rutland* case the Circuit Court of Appeals for the Second Circuit handed down a supplemental opinion (143 Fed. (2d), 190, (1944)) denying rehearing but specifically distinguishing the *Seaboard* case from the *Rutland* case on the ground that the Seaboard receivership had been begun before the enactment of Section 77. The Court said:

> "But in the Seaboard case the equity receivership had been begun before the enactment of Section 77, so that it had not been irregularly instituted."

The institution of the Seaboard receivership in 1930 could not have been a violation of any congressional policy announced in 1933, when Section 77 was enacted.

Moreover, in the *Rutland* case a petition under Section 77 had been filed by the debtor, which was specifically entitled to file such a petition under the provisions of Section 77. In the *Seaboard* case no such petition has ever been filed either by the debtor or by any security holder or group of security holders. There is nothing in Section 77 which permits the institution of proceedings under that section by anyone other than the debtor or security holders. It would, therefore, have been impossible for the District Court to compel the institution of proceedings under Sec-

tion 77 even if that Court had desired to do so. All parties before the District Court, except these petitioners, expressed their desire that the reorganization should continue in equity, for the reason that a transfer to Section 77 at that late date would, it was believed, delay for many more years the completion of the reorganization.

The Circuit Court of Appeals fully discussed the *Rutland* case in its opinion (R. Vol. III, pp. 23-25).

So far as we know, the Seaboard reorganization is the only railroad reorganization now pending in equity proceedings. There is, therefore, no question of public or general interest for this Court to review in connection with the decision to permit the Seaboard reorganization to be completed in equity. The public interest will be served by the denial of the petition for *certiorari*, so that this reorganization may be promptly consummated, after so many years in the Courts.

POINT II

Petitioners did not object to the Committee in the Courts below, and may not be heard to do so now. In any event, the appointment of the Committee by the District Court was entirely consistent with usual, customary and proper reorganization procedure.

(a) Petitioners having accepted the Committee in the Courts below may now not object to the Committee.

Petitioners were present and participated in the hearings at which the Committee was appointed. They made no objection to the appointment of the Committee or to its membership. They conferred with the Committee and pre-

sented to the Committee their views as to the treatment which the Georgia & Alabama Bonds were entitled to receive. They opposed the recommendations of the Committee after they were made and appealed to the Circuit Court of Appeals from the decision approving a reorganization plan consistent with those recommendations, but they did not, in their appeal to the Circuit Court of Appeals, object to the appointment of the Committee or to its membership. Since no objection was made by petitioners to the Committee before the District Court, or on the appeal to the Circuit Court of Appeals, this Court will not consider any such objection as a basis for certiorari. *Robinson* v. *Belt,* 187 U. S. 41 (1902); *Duignan* v. *United States,* 274 U. S. 195 (1927).

(b) The appointment of the Committee was entirely proper and in accordance with accepted procedure.

In the first hearings before the Courts on the Plan approved by the Special Master the Courts found sharp differences of opinion among the actively interested parties as to many of the questions raised by the Special Master's Report.

The Courts, therefore, determined to appoint three of the counsel who had taken a leading part in the hearings as a Committee to meet with other interested parties, to consider the problems raised and to make recommendations to the Courts as to what modifications, if any, should be made in the Plan recommended by the Special Master.

The three persons appointed were Mr. Delano Andrews, representing the Committee for Consolidated Mortgage Bonds (one of the general mortgage issues); Mr. Joseph France, counsel for the Underlying Bondholders Committee; and Mr. E. S. S. Sunderland, counsel for the Trustee

under the Consolidated Mortgage. Those gentlemen were appointed because the Courts believed that through their intimate knowledge of the Seaboard picture and their experience in railroad reorganizations they would be best equipped to make recommendations to the Court for fair and equitable modifications of the Special Master's Plan if such modifications were deemed necessary. It was obviously impossible to appoint to such a committee representatives of all of the many different security issues which were involved in the reorganization.

The Committee so appointed conferred with all parties who desired to present their views and thereafter made their report to the Courts recommending certain modifications of the Special Master's Plan, including one modification (the Tertiary Allocation) which, while now criticized by the petitioners, had up to that point been strongly urged by them on the basis of the testimony and recommendations of Mr. Wyer, the expert for the Underlying Committee.

It is not true, as the petition states, that the Committee gave no explanation of the changes which they recommended. They filed a full report and exhibits which appear in Vol. I of the Record at pages 413 to 433. Both the expert employed on behalf of the Underlying Bonds (Mr. Wyer) and the expert employed on behalf of the general mortgage issues (Mr. Kennedy) testified that they believed that the result reached by the Committee was fair. The District Courts arrived at an independent appraisal of the fairness of the modified Plan, not alone on the basis of the report of the Committee and that expert testimony, but primarily on the evidentiary foundation of the entire reorganization record. The District Courts were free to accept or reject, in whole or in part, the

modifications recommended by the Committee, and on the basis of the evidence before them decided to accept those modifications. There was no error in that procedure. *U. S.* v. *Crescent Amusement Company*, U. S. Supreme Court, December 12, 1944, 13 L. W. 4045, 4047.

The opinion, findings and conclusions of the Virginia Court show that the Virginia Court did not relinquish or delegate any part of its judicial responsibility. The petitioners distort the record in saying, that the Committee purported to function in a "*judicial*" capacity. The members of the Committee—all of whom were members of the Bar—stated in their report (R. Vol. I, p. 414) that they "have considered themselves to be in the position of officers of the Courts." That is a normal function of lawyers, and is entirely separate from the judicial function of the Courts.

This procedure was proper and normal procedure in any railroad reorganization, and entirely consistent with the practice of the Interstate Commerce Commission and the Courts in reorganization under Section 77. A similar Committee was appointed by Judge Hincks in the New Haven reorganization case (see *In re New York, N. H. & H. R. Co.*, 54 F. Supp. 595, 610 (1943)) to aid the Court in solving the many problems arising in that reorganization. That Committee recommended a reorganization plan differing in many respects from that theretofore approved by the Interstate Commerce Commission. The Interstate Commerce Commission, after hearings, accepted with minor modifications the plan recommended by the Committee and the Court approved that plan with certain additional relatively minor modifications.

In the Central of Georgia reorganization, Judge Lovett appointed a committee of representatives of various groups of creditors to advise with the Trustee under Section 77 in connection with the formulation of a reorganization plan.

In many cases the Interstate Commerce Commission has approved reorganization plans agreed on by substantial groups of creditors even though no formal compromise committee has been designated. The plans recently approved for the St. Louis-San Francisco and the Missouri Pacific were in major substance the plans recommended to the Commission by three bondholders' committees in the case of the Frisco and by a substantial number (but not all) of the interested parties in Missouri Pacific.

This Court recognized in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939) that compromises among the interested parties were a normal part of the reorganization process. This Court said at page 130:

> "Of course, this is not to intimate that compromise of claims is not allowable under Section 77B. * * * Settlement of such conflicting claims to the *res* in the possession of the court is a normal part of the process of reorganization. In sanctioning such settlements the court is not bowing to nuisance claims; it is administering the proceedings in an economical and practical manner."

In summary, it is clear that the procedure followed by the District Court was proper and entirely in accord with "the accepted and usual course of judicial proceedings." The report of the Committee was received only for the guidance of the Courts, in the nature of "expert testimony". It did not bind any interest which did not ac-

cept it. It was not the report of the Committee, but the judicial action of the District Court in considering and approving the fairness of the recommendations, which had any legal effect. The District Court held that the result accomplished was a fair and equitable result and the Circuit Court of Appeals affirmed that decision. No question is presented which justifies a review of that decision by this Court.

If the Virginia Court had approved the Special Master's Plan without modifications, the Circuit Court of Appeals would have been obliged to sustain the District Court under Rules 52(a) and 53(e)(2) of the Rules of Civil Procedure, and this Court would not have entertained a review of the findings of the District Court on questions of fact. Here, however, the modifications recommended by the Committee and approved by the District Court awarded the Georgia & Alabama bondholders a larger share of new securities than they would have received under the Special Master's Plan, including some First Mortgage Bonds. No First Mortgage Bonds were allotted to them by the Special Master. Petitioners have no cause to complain that they were injured by the modifications which improved their position.

POINT III

No question of "compensation" to the Georgia & Alabama Bonds arises in this case.

This Court held in the *Milwaukee* case (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523, 1943) that a senior creditor required to take inferior securities in a

reorganization was entitled to compensation for the loss of senior rights *if junior creditors were also allowed to participate.* Petitioners seek to bring this case before this Court on the ground that the Georgia & Alabama Bonds did not receive adequate compensation within the rule established by this Court in the *Milwaukee* case.

There can be no question of compensation for the Georgia & Alabama Bonds in this case because no junior creditor is participating in the value of the property securing the Georgia & Alabama Bonds. The full value found for that property by the Special Master and the District Courts was allotted to the holders of the Georgia & Alabama Bonds and no part of that value was allotted to any other creditor. There is, therefore, no reason to "compensate" the Georgia & Alabama Bonds.

The problem in relation to the relative treatment of the Georgia & Alabama Bonds and the other Underlying issues is exactly the same as the problem of the relative treatment of the General Mortgage Bonds and the 50-year bonds which this Court discussed in the *Milwaukee* case. In that case this Court said at page 563:

> "But where, as here, each group of bondholders is contributing to a new system mortgage separate properties from old divisional mortgages, it is necessary to fit each into the hierarchy of the new capital structure in such a way that each will retain in relation to the other the same position it formerly had in respect of assets and of earnings at various levels. If that is done, each has obtained new securities which are the equitable equivalent of its previous rights, and the full priority rule of the *Boyd* case, as applied to the rights of creditors *inter se*, is satisfied. That rule was applied here. And the determination by the Commission and the District Court that its

requirements were satisfied is supported by evidence. * * *"

POINT IV

Questions as to the methods of determining the relative values of the various properties are not questions of public or general interest.

This Court will not grant certiorari to review the details of the methods adopted by the Special Master and by the District Court in determining relative allotments of securities. This Court did not grant certiorari for that purpose in the *Milwaukee* case or in the *Western Pacific* case (*Ecker* v. *Western Pacific R. Co.,* 318 U. S. 448, (1943)), nor has it ever granted certiorari for that purpose in any case.

Certiorari was granted in the *Milwaukee* and *Western Pacific* cases because those cases involved basic questions of the relative jurisdiction of the Commission and the Courts in proceedings under Section 77 and of the nature and character of findings which had to be made in such reorganizations by the Commission. There were sharp conflicts between the decisions of the lower courts on those matters and reorganizations under Section 77 could not proceed until those basic questions were authoritatively settled. There are no such questions in this case.

Even after it had granted certiorari, this Court did not, in the *Western Pacific* case, consider the correctness of the security allocations made in the Western Pacific Plan except in so far as such allocations depended on a question of law, viz., conflicting lien claims of two mortgages.

In the *Milwaukee* case this Court did discuss certain of the allocations for new securities among the several

issues. This Court, however, expressly refused to review the methods by which the Commission and the District Court had arrived at those allocations, nor did it pass on the allocations as such. This Court said at page 561:

> "The problem in such a case is not a simple one. The contribution which each division makes to a system is not a mere matter of arithmetical computation. It involves an appraisal of many factors and the exercise of an informed judgment. * * * In the present case the Commission and the District Court were satisfied that they had adequate data based on earning power to make a fair allocation of new securities between the general mortgage bonds and the 50-year bonds. We can not say that it was inadequate. * * * *The earning periods to be chosen, the methods to be employed in allocating system earnings to the various divisions, are matters for the informed judgment of the Commission and the Court.* * * *
>
> "We would have quite a different problem if the District Court had failed to perform the functions which Section 77(e) places upon it. But it can not be said that there was any such failure here. * * * Since such a determination rests in the realm of judgment rather than mathematics, there is an area for disagreement. But we are not performing the functions of the District Court under Section 77(e). Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. *If there is warrant for the action of the District Court, our task on review is at an end.*" (Italics supplied)

In this case there can be no question that the Special Master and the District Court carefully and earnestly performed their "functions," i.e., the determination of a fair and equitable allocation of securities, in accordance with the

general principles laid down by this Court in the *Western Pacific* and *Milwaukee* cases, and the methods followed by the Interstate Commerce Commission in reorganizations under Section 77. Even if this Court were to grant *certiorari* in this case, it would not review the action of the District Court in respect of allocations of securities among the several divisional mortgages. It follows, of course, that this Court will not grant certiorari on the basis of any of the questions presented by the petition (questions 5 to 10, inclusive) which deal solely with matters of allocation.

POINT V

There is no ground for granting the petition.

Paragraph 5 of Supreme Court Rule 38 states that a review on writ of certiorari will be granted only when there are special and important reasons therefor. No such reasons have been shown to exist in this case and it is obvious that petitioners have attempted, by stating a multitude of alleged "questions", to disguise the fact that there is no ground for *certiorari* in this case.

The opinion on rehearing on the *Rutland* case (which petitioners failed to mention) makes it clear beyond question that the *Rutland* decision was not applicable to an equity reorganization started before 1933, as was the Seaboard reorganization, and that there is, therefore, no conflict between that decision and the decision of the Circuit Court of Appeals in this case.

All of the other questions stated in the petition relate only to the procedure adopted by the District Court and the methods approved by it. The procedure which is criticized (*i.e.*, the appointment of the Committee to confer

and suggest) was normal and proper procedure. The question of methods of allocation is, as this Court has stated in the *Milwaukee* case, one for the informed discretion of the District Court and the choice of the appropriate method is dependent on the facts of each case. It would not serve the public interest for this Court to review a specific problem of allocation when its decision could have no application to any other reorganization case.

Accordingly, the petition for certiorari should be denied.

Dated December 26, 1944.

Respectfully submitted,

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Attorneys for Respondents.

SCHEDULE A

INTERSTATE COMMERCE COMMISSION

FINANCE DOCKET No. 14500

SEABOARD AIR LINE RAILWAY COMPANY
RECEIVERSHIP

SUBMITTED JUNE 3, 1944. DECIDED AUGUST 12, 1944.

Upon consideration of the application for authority to issue securities under a plan of reorganization in receivership proceedings, found that the record supports the issue of such securities and assumption of obligations in the amounts and substantially of the character proposed, viz,

(1) Issue of not exceeding $32,500,000 of first-mortgage 50-year 4-percent bonds, series A, $52,500,000 of income-mortgage 70-year 4½-percent bonds, series A, $15,000,000 of preferred stock 5 percent, series A, of the par value of $100 a share, and 850,000 shares of common stock without par value, but with a stated value of $100 a share, and such additional shares of common stock not exceeding 675,000 shares as may be necessary to comply with the conversion rights of the income-mortgage 70-year 4½-percent bonds, series A, and the preferred stock, series A, that may be issued under the plan.

(2) Assumption of obligations and liabilities, under the terms and conditions, and to the extent contemplated by the plan,

(a) Of Legh R. Powell, Jr. and Henry W. Anderson, as receivers of the Seaboard Air Line Railway Company, as guarantors, in respect of not exceeding $11,870,000 of receivers' equipment-trust certificates, and of such additional receivers' equipment-trust cer-

tificates, the guaranty of which may be authorized by the Commission prior to the entry of an order herein;

(b) Of the Seaboard Air Line Railway Company or the receivers, or both, as guarantors and lessees, in respect of the following securities: Birmingham Terminal Company first-mortgage 4-percent bonds, $323,333.33; Jacksonville Terminal Company first and general mortgage 5-percent bonds, $100,000, refunding and extension mortgage 5-percent bonds, series A, $2,400,000, refunding and extension mortgage 6-percent bonds, series B, $1,100,000, refunding and extension mortgage 4½-percent bonds, series C, $400,000; Tampa Union Station Company first-mortgage 4-percent bonds, $210,000; and as guarantors in respect of Norfolk & Portsmouth Belt Line Railroad Company 1½-percent promissory notes, $420,000;

(c) Of the Seaboard Air Line Railway Company, or the receivers, or both, as lessee, by lease or operating agreement in respect of the following securities, insofar as rental payments are involved: Athens Terminal Company first-mortgage 5-percent bonds, $200,000; Birmingham Terminal Company, 1500 shares of capital stock of the par value of $100 a share; Durham Union Station Company first-mortgage 5-percent bonds, $60,000, and 333 shares of capital stock of the par value of $100 a share; North Charleston Terminal Company, 1050 shares of capital stock of the par value of $100 a share; Savannah Union Station Company first-mortgage 4-percent bonds, $600,000; Tampa Union Station Company, 300 shares of capital stock of the par value of $100 a share; and Atlanta Terminal Company first-mortgage 4-percent bonds, $1,600,000, and 1500 shares of capital stock of the par value of $100 a share.

LEONARD D. ADKINS for applicant.

REPORT OF THE COMMISSION

DIVISION 4,

COMMISSIONERS PORTER, MAHAFFIE, AND MILLER

By DIVISION 4:

The Seaboard Railway Company, hereinafter called the new company, a newly organized company incorporated for the purpose of engaging in interstate commerce, on March 9, 1944, applied for authority under Section 5 (2) (a) of the Interstate Commerce Act to acquire certain properties and interests in properties, hereinafter described, of the Seaboard Air Line Railway Company, hereinafter referred to as the old company, or its receivers, or both; and on the same date applied for authority under sections 5 (2) (a), 5 (15), and 5 (16) of the act to acquire from the old company or the receivers, or both, certain stock interests and indebtedness of the Baltimore Steam Packet Company, a common carrier by water, Finance Docket No. 14501. On the same date it also filed an application under section 20a of the act seeking authority (1) to issue, under the terms and conditions and to the extent contemplated by a proposed plan of reorganization, hereinafter referred to as the plan, the following securities in temporary form or as interim certificates, or in definitive form, and, if issued either in temporary form or as interim certificates, in definitive form in exchange therefor; and in the first instance, in lieu of fractions of a bond or share of stock, non-interest-bearing or non-dividend-bearing and non-voting scrip certificates therefor, not exceeding $32,500,000 of first-mortgage 40-year 4-percent bonds, series A, $52,500,000 of income-mortgage 50-year 4½-percent bonds, series A, $15,000,000 of preferred stock 5 percent, series A, consisting of 150,000 shares of the par value of $100 a share, and 850,000 shares of common stock without par value; and to issue from time to time such additional shares of common stock up to 675,000 shares, as may be necessary to comply with the conversion rights of the income-mortgage 50-year 4½-percent bonds, series A, and the preferred stock, series A, that may be issued under the plan; (2) to assume, under the terms and conditions and to the extent contemplated by the plan, the obligation and liability of Legh R. Powell, Jr., and Henry W. Anderson, as receivers of

the old company, as guarantors, in respect of not exceeding $11,870,000 of receivers' equipment-trust certificates, and such additional receivers' equipment-trust certificates, the guaranty of which may be authorized by us prior to the entry of an order herein; (3) to assume, under the terms and conditions and to the extent contemplated by the plan, the obligation and liability of the old company or the receivers, or both, as guarantors, and as lessee (except as to Norfolk & Portsmouth Belt Line Railroad notes), in respect of the following securities: $1,940,000 of first-mortgage 4-percent bonds of the Birmingham Terminal Company, $100,000 of first and general mortgage 5-percent bonds, $2,400,000 of refunding and extension mortgage 5-percent bonds, series A, $1,100,000 of refunding and extension mortgage 6-percent bonds, series B, and $400,000 of refunding and extension mortgage 4½-percent bonds, series C, all of the Jacksonville Terminal Company, $420,000 of 1½-percent serial promissory notes of the Norfolk & Portsmouth Belt Line Railroad Company, and $210,000 of first-mortgage 4-percent bonds of the Tampa Union Station Company; (4) to assume the obligation and liability of the old company or the receivers, or both, as lessee by lease or operating agreement, in respect of $200,000 of first-mortgage 5-percent bonds of the Athens Terminal Company, 1,500 shares of capital stock of the par value of $100 each of the Birmingham Terminal Company, $60,000 of first-mortgage 5-percent bonds of the Durham Union Station Company, 333 shares of capital stock of the par value of $100 each of the Durham Union Station Company, 1,050 shares of capital stock of the par value of $100 each of the North Charleston Terminal Company, $600,000 of first-mortgage 4-percent bonds of the Savannah Union Station Company, 300 shares of capital stock of the par value of $100 each of the Tampa Union Station Company, $1,600,000 of first-mortgage 4-percent bonds of the Atlanta Terminal Company, and 1,500 shares of capital stock of the par value of $100 each of the Atlanta Terminal Company, such assumption of obligation and liability to extend only to rental payments in amounts equivalent to interest, dividends, or sinking-fund installments on the above-named securities, and to exclude any obligation of the old company or the receivers, or both, in respect of the principal of, or interest or dividends or sinking-fund installments on these securities. A hearing was held and a brief was filed by the appli-

cant. No representations have been made by State authorities, and no formal objection to the applications has been offered.

The applicant was incorporated under the laws of the Commonwealth of Virginia on January 26, 1944, for the purpose of acquiring by purchase, lease, or otherwise, certain properties and rights and interests now owned by the old company, or operated by it or its receivers, or in possession of either or both.

20a Application to Test Amount of Capitalization

The present application was filed under the provisions of section 20a of the Interstate Commerce Act for the purpose of determining whether the capitalization proposed in the plan would be approved, and a report on this phase of the application has been requested. If the securities contemplated by the plan are disapproved, proceedings under section 77 of the Bankruptcy Act probably will be instituted.

The old company is a consolidated corporation organized in 1915 under the laws of Virginia, North Carolina, South Carolina, Georgia and Florida. At the end of 1943 the receivers operated a railroad system extending from Richmond and Norfolk, Va., in a general southerly direction through the cities of Savannah, Ga., Jacksonville and Miami, Fla., to Homestead on the east coast and St. Petersburg, Tampa, Naples, and other points on the west coast of Florida with branches to Bessemer and Montgomery, Ala., Wilmington, N. C., and various other points, a total operated mileage of all tracks of 5,703.06 miles, which includes 4,076.13 miles of main line, 101.62 miles of branch lines, 64.47 miles of second main track, 562.15 miles of passing tracks, etc., 447.76 miles of way and switching tracks and 450.93 miles of yard switching tracks. This mileage does not include 98.22 miles of switching tracks owned by shippers. At the end of the same year it had 613 locomotives available for service, of which 242 were fully owned, 339 held under equipment trusts, 11 leased and 21 held under other forms of lease or title. Of these 553 were steam locomotives and 60 were Diesels. There were also available for service 17,679 freight-carrying cars and 412 passenger-train cars of all classes, 628 units of company service equipment, and 14 units of floating equipment.

Receivership of Old Company

On December 23, 1930, Legh R. Powell, Jr., and Ethelbert W. Smith were appointed receivers of the properties of the old company by order of the District Court of the United States for the Eastern District of Virginia in a cause entitled *Bethlehem Steel Company* v. *Seaboard Air Line Railway Company in Equity No. 213.* Ancilliary proceedings were also instituted in the District Court of the United States for the Southern District of Florida. Subsequently Smith was succeeded by Henry W. Anderson and the various receivership proceedings were consolidated and are now entitled *Guaranty Trust Company of New York and Merrell P. Callaway, as Trustees, et al.* v. *Seaboard Air Line Railway Company et al. Consolidated Cause in Equity No. 214.* On October 27, 1939, the District Court of the United States for the Eastern District of Virginia in the above-entitled consolidated cause appointed Tazewell Taylor as special master of that court and, among other things, authorized any creditor, security holder, or group or committee representing creditors, security holders ar stockholders, respectively, of the old company or its receivers, with a substantial interest, to petition the court at any time prior to February 1, 1940, unless extended, for leave to intervene in that proceeding for the purpose of proposing a plan of reorganization. On July 20, 1943, the special master submitted his report which included a rceommended plan of reorganization. Hearings were held in respect thereto in October and November 1943, after which the court appointed a conference committee as a result of which modifications of the plan were submitted. The plan as modified was confirmed on December 13, 1943, by the Virginia court and on December 15, 1943, by the Florida court.

Properties to be Acquired by the New Company

The new company was incorporated for the purpose of acquiring approximately 4,178 miles of main line or lines of the old company. Under the plan it is proposed to include in a unified railroad system (a) all the properties heretofore owned outright by the old company, (b) all the wholly owned subsidiaries operated by the old company, (c) subsidiaries partly owned but with some understanding debt or stock held by the public, and (d) leased lines. These properties are now subject, in whole or in

part, to 18 separate mortgages. The proposed plan contemplates a single new system subject to new consolidated system mortgages and the elimination of all prior liens. It is also proposed to acquire all stocks, obligations, securities, or other interests in other companies or separately operated property held by the old company or its receivers at the time the plan is effective, to the extent described. A summary of the properties to be acquired is given following:

I. The lines of railroad and other assets of the old company and of those subsidiary companies which were operated by it prior to the receivership under leases or other operating agreements and are now operated by the receivers of the old company as a part of the Seaboard system:

(a) Wholly owned railroad subsidiaries whose property may or may not be acquired by the receivers before consummation of the plan are:

Brooksville & Inverness Railway

Charlotte Harbor & Northern Railway Company

Prince George & Chesterfield Railway

(b) Railroad terminal subsidiaries with outstanding publicly held securities operated by the old company.—The properties of the following subsidiaries will be acquired; or control thereof resulting from the acquisition by the new company of mortgage bonds of such railroads in exchange for securities or cash pursuant to the plan, and thereafter the properties of such railroads, or control of successor corporations by the acquisition from the receivers, the old company, or the reorganization committee, or from 2 or more of these sources, of the stock of such corporations, and thereafter their properties; or control of the last 3 companies by acquisition of their mortgage bonds in exchange for securities or cash pursuant to the plan, and by the acquisition of all outstanding capital stock and debt of these companies from the old company or its receivers, and thereafter the acquisition of the properties of these companies:

Georgia, Florida & Alabama Railroad Company

Tampa Northern Railroad Company (including its ownership of 100 shares of the 300 outstanding shares of stock of Tampa Union Station Company)

Georgia and Alabama Terminal Company

Tampa & Gulf Coast Railroad Company

Either (i) the properties of the following railroads from the old company or its receivers, or (ii) such control of these railroads as may result from the acquisition by the new company of Seaboard-All Florida first-mortgage bonds from the receivers or the reorganization committee, or both, and thereafter the properties of such railroads for such consideration, if any, in addition to such bonds so acquired as may be submitted to us for consideration prior to the entry of a supplemental order authorizing such acquisition of the properties, or (iii) control of any corporations, successors to such railroads, by acquisition from the receivers or the reorganization committee, or both, of the stock of such corporations, and thereafter their properties. This group consists of

Seaboard-All Florida Railway

Florida Western & Northern Railroad Company

East and West Coast Railway

these 3 being known as the Seaboard-All Florida Lines.

II. *Separately operated lines.*—(a) Control through ownership of the following shares of capital stock of such railroads, such shares now being owned by the old company or held for the benefit of the receivership estate of the old company by its receivers, except insofar as such shares may hereafter and prior to the consummation of the plan be disposed of in exchange for property of the railroad issuing such shares:

Macon, Dublin & Savannah Railroad Company, 17,500 shares of common stock, 100 percent control,

Tavares and Gulf Railroad Company, 2,982 shares of common stock, 100 percent control,

Brooksville and Inverness Railway, 25 shares of common stock, 100 percent control,

Charlotte Harbor & Northern Railway Company, 5,000 shares of preferred, 35,000 shares common stock, 100 percent control,

Prince George and Chesterfield Railway, 50 shares of common stock, 100 percent control,

and (b) the stock interests and other investments of the old company in its following subsidiaries, which were or are separately operated:

Macon, Dublin & Savannah Railroad Company,

Charlotte, Monroe and Columbia Railroad Company (lines abandoned),

Chesterfield and Lancaster Railroad Company (lines abandoned),

Raleigh & Charleston Railroad Company (lines abandoned),

Jacksonville, Gainesville & Gulf Railway (property sold under foreclosure proceedings but operations being continued for account of purchaser),

Tavares and Gulf Railroad Company.

III. *Line owning principally equipment.*—The new company will acquire the assets of the following company, which consist principally of equipment and equipment-trust obligations assumed by the old company. All of the equipment is leased to the old company by agreement dated November 1, 1923, and supplements thereto. The lease has not been affirmed or disaffirmed by the receivers of the old company, but the equipment has been used by the receivers, pursuant to court orders:

The Seaboard-Bay Line Company.

IV. *Water-carrier company securities.*—The new company proposes to acquire all of the funded debt, consisting of $1,500,000, principal amount of debentures, due January 1, 1991, and two 5-percent promissory notes in the principal amount of $90,000 each, due on or before April 1,

1952, and April 1, 1953, respectively, and 50 percent of the capital stock, or 200 shares of common stock of the par value of $1,000 a share, of the Baltimore Steam Packet Company.

V. *Joint control of other carriers.*—The new company will also acquire joint control with other carrriers of the following railroad, express, or terminal companies, through ownership of the shares of stock of each to the extent shown:

Albany Passenger Terminal, 55 shares, $100 par, 4.58 percent

Athens Terminal Company, 125 shares, $100 par, 50 percent

Birmingham Terminal Company, 250 shares, $100 par, 16⅔ percent

Chatham Terminal Company, 250 shares, $100 par, 50 percent

Columbia, Newberry and Laurens R. Co., 3,335 shares, $25 par, 16⅝ percent

Durham Union Station Co., 83⅓ shares, $100 par, 25 percent

Fruit Growers Express Co., 10,777 shares, $100 par, 12.92 per cent

Jacksonville Terminal Co., 938 shares, $100 par, 25 percent

Norfolk & Portsmouth Belt Line R. Co., 72 shares, $100 par, 12½ percent

North Charleston Terminal Co., 350 shares, $100 par, 33⅓ percent

Railway Express Agency, Inc., 17 shares, no par, 1.7 percent

Richmond-Washington Co., 6,675 shares, $100 par, 16⅔ per cent

Savannah Union Station Co., 1,000 shares, $100 par, 33⅓ percent

Tampa Union Station Co., 200 shares, $100 par, 66⅔ percent

The Wilmington Railway Bridge Co., 200 shares, $100 par, 50 percent

VI. *Leasehold interest.*—The new company will acquire the leasehold interests of the old company or its receivers in the properties of the following lessors, except to the extent that such leases may hereafter be disaffirmed by the receivers or the properties of such lessors, except those marked with an asterisk, may hereafter be acquired by the receivers or the new company:

Brooksville and Inverness Railway. Lease of January 5, 1926, as supplemented October 1, 1928, to old company.

Charlotte Harbor & Northern Ry. Co. Lease of March 1, 1928, as supplemented July 23, 1928, to old company.

Prince George and Chesterfield Railway. Lease of January 16, 1930, to old company.

Georgia and Alabama Terminal Company. Lease of December 20, 1898, to Georgia and Alabama Ry., and supplemented thereto, dated January 1, 1925, between terminal company and the old company.

Tampa & Gulf Coast Railroad Company. Lease of January 31, 1927, as supplemented October 1, 1928, to old company

Tampa Northern Railroad Company. Lease of January 5, 1926, as supplemented October 1, 1928, to old company.

*Central of Georgia Railway Company. Lease of March 28, 1896, to Georgia and Alabama Railway, conveyed by latter to a predecessor in title to old company under date of February 20, 1902.

*Georgia Power Company (Columbus Railroad Company, predecessor). Lease of October 31, 1901, between predecessor company and predecessor of old company and supplements thereto.

*McRae Terminal Company. Lease of December 31, 1909, as supplemented August 17, 1914, and November 22, 1924, between terminal company and a predecessor of old company.

VII. *Trackage rights and joint use of facilities.*—The new company will also acquire the rights now vested in the old company or its receivers to trackage over, or joint use of, lines of railroad and terminals owned or operated by the following railroads and terminal companies, except to the extent that the agreements creating such trackage rights or rights of joint use may hereafter be disaffirmed by the receivers or the new company:

Joint Yard, Savannah, Ga. Agreement of May 1, 1916, between Central of Georgia Railway Co., the old company, and the Chatham Terminal Company.

Hilton to Navassa, N. C. Agreement of November 18, 1866, as supplemented May 22, 1909, and May 25, 1926, between the Atlantic Coast Line Railroad Co., or its predecessors, and the old company, or its predecessors or receivers of the old company, covering operations of properties of Wilmington Railway Bridge Co.

River Junction, Fla. Agreement dated February 28, 1908, confirmed November 17, 1910, between the Atlantic Coast Line Railroad Company, Louisville & Nashville Railroad Company, predecessor of old company, or its receivers, and the receiver of the Appalachicola Northern Railroad.

Cuthbert, Ga. Memorandum of agreement, dated December 29, 1923, between Central of Georgia Railway Company and Georgia, Florida and Alabama Railway (assumed by old company).

Savannah, Ga. Agreement dated May 1, 1902, amended March 1, 1920, between Savannah Union Station Company, Southern Railway Company, Atlantic Coast Line Railroad Company, and the old company.

Athens, Ga. Operating agreement, dated February 19, 1943, between the Athens Terminal Company, the receivers, and the Gainesville Midland Railroad Company.

Atlanta, Ga. Agreement dated August 19, 1916, between Atlanta Terminal Company, the old company,

the Southern Railway Company, Central of Georgia Railway Company, Atlanta & West Point Railroad Company, Atlanta, Birmingham & Atlantic Railway Company, and Guaranty Trust Company of New York.

Howells, Ga., to Freight Depot, Atlanta, Ga. Contract dated November 14, 1930, between The Nashville, Chattanooga & St. Louis Railway, Western & Atlantic Railroad and the old company.

Howells, Ga., to Terminal Station, Atlanta, Ga. Agreement dated August 11, 1916, as supplemented July 1, 1921, between Southern Railway Company and the old company, and supplemental agreement dated June 1, 1936, between the receivers and the Southern Railway Company.

Birmingham, Ala. Agreement of April 12, 1917, between the Southern Railway Company, the Alabama Great Southern Railroad Company, Central of Georgia Railway Company, Illinois Central Railroad Company and the old company, as modified by letter agreement dated November 7, 1936, between Southern Railway Company, and the receivers.

Birmingham, Ala. Agreement dated March 1, 1907, as supplemented May 18, 1907, and March 29, 1915, between Birmingham Terminal Company, Southern Railway Company, Illinois Central Railroad Company, a predecessor of old company, Central of Georgia Railway Company, St. Louis & San Francisco Railroad Company, Alabama Great Southern Railroad Company, and The Equitable Trust Company of New York.

Birmingham, Ala. Agreement dated February 12, 1903, as supplemented August 22, 1904, May 13, 1909, and February 1, 1912, between Birmingham Belt Railroad Company and certain predecessors in title of the old company, as amended by agreement dated January 26, 1940, between the receivers and the Birmingham Belt Railroad Company, trustees of St. Louis-San Francisco Railway Company, receiver

of Central of Georgia Railway, and Illinois Central Railroad Company.

Birmingham (Freight Yard Jct.) to Bessemer, Ala. Agreement dated February 12, 1903, as supplemented June 1, 1905, between Kansas City, Memphis & Birmingham Railroad Company and predecessors in title of Seaboard Air Line Railway, a predecessor of the old company.

Montgomery, Ala. Agreement dated November 20, 1899, between Central of Georgia Railway Company and Georgia and Alabama Railway, a predecessor of the old company.

Montgomery, Ala. Agreement effective on and after May 1, 1898, between Louisville & Nashville Railroad Company and Georgia & Alabama Railway, a predecessor in title of the old company, covering use of union passenger station facilities.

Jacksonville, Fla. Agreement dated June 1, 1917, as supplemented October 1, 1921, between Jacksonville Terminal Company, Atlantic Coast Line Railroad Company, Florida East Coast Railway Company, the old company, Southern Railway Company, and United States Trust Co. of New York; also agreement dated April 4, 1939, between Jacksonville Terminal Company, Atlantic Coast Line Railroad Company, the receivers of Florida East Coast Railway, receivers of the old company, Southern Railway Company, and the United States Trust Company of New York.

Tampa, Fla. Agreement dated November 1, 1940, between Tampa Union Station Co., the receivers, and Atlantic Coast Line Railroad Company.

Raleigh to Cary, N. C. Agreement dated January 5, 1915, as supplemented January 1, 1926, between Southern Railway Company and the old company, or a predecessor in title.

Miscellaneous tracks. 3.39 miles of miscellaneous passing, switching, and other tracks owned by other rail-

roads over which the old company has trackage rights.

VIII. *Consideration for acquisition of properties.*—To acquire the properties and rights above described the new company proposes to use presently $5,584,290 of cash, and to issue securities and assume obligations and liabilities as follows:

IX. *Securities Issues:* It is proposed to issue a maximum amount of

$32,500,000 of first-mortgage 40-year 4-percent bonds, series A;

52,500,000 of income-mortgage 50-year 4½-percent bonds, series A;

15,000,000 of preferred stock 5 percent, series A, par value $100;

85,000,000 of common stock without par value, but with stated value of $100 a share; and an an additional amount not exceeding

67,500,000 of common stock, or such part thereof as may be necessary to comply with the conversion rights of the income-mortgage 4½-percent bonds, series A, and preferred stock, series A, as may be issued under the plan.

X. *Assumption of obligation and liability.*—

(a) *Receivers' obligations.* Pursuant to the plan it is proposed to assume obligation and liability of the receivers of the old company, as guarantors, in respect of not exceeding

$11,870,000 of receivers equipment-trust certificates and in respect of such additional amounts of these certificates, the guaranty of which by the receivers may be authorized by us hereafter but prior to the entry of an order herein.

(b) *Obligations of receivers of old company, or both, as guarantors and lessees,* in respect of the following securities:

$1,940,000 of Birmingham Terminal Company first-mortgage 4-percent bonds, due March 1, 1957, guaranteed severally by 6 companies; old company's portion $323,333.33.

*100,000 first and general mortgage 5-percent bonds, due July 1, 1967, guaranteed jointly and severally.

*2,400,000 refunding and extension mortgage 5-percent bonds, series A, due July 1, 1967, guaranteed jointly and severally.

*1,100,000 refunding and extension mortgage 6-percent bonds, series B, due July 1, 1967, guaranteed jointly and severally.

*400,000 refunding and extension mortgage 4½-percent bonds, series C, due July 1, 1967, guaranteed jointly and severally. Those marked with asterisk are securities of Jacksonville Terminal Company.

210,000 first-mortgage 4-percent bonds of Tampa Union Station Company, due October 1, 1958, guaranteed jointly and severally.

(c) *Obligations of receivers or old company, or both, as guarantors,* in respect of the following securities:

$420,000 of Norfolk and Portsmouth Belt Line Railroad Company 1½-percent serial promissory notes, due in annual installments of $70,000 each on September 1 in each year to and including September 1, 1949, guaranteed jointly and severally.

(d) *Obligations of receivers or old company, or both, as lessee,* (by lease or operating agreement) in respect of the following securities, to the extent that the old company, or its receivers, or both, are obligated to pay as rent an amount equivalent to interest,

dividends, or sinking-fund installments on these securities, and without creating or retaining any obligation or liability of the old company or its receivers, or both, in respect of the principal of, or the interest or dividends or sinking-fund installments on these securities:

Athens Terminal Co.—$200,000 of first-mortgage 5-percent bonds. Operating agreement dated February 19, 1943, between that company and the Gainesville Midland Railroad Company.

Birmingham Terminal Company.—1,500 shares of capital stock, $100 par value, owned in equal amounts by 5 lessee companies. Agreement dated March 1, 1907, as supplemented May 18, 1907, and March 29, 1915.

Durham Union Station Company.—$80,000 of first-mortgage 5-percent bonds, due May 1, 1955. Agreement dated May 1, 1905, as amended December 10, 1907, between that company and 4 lessees, 1 the old company's predecessor. Also 333 shares of capital stock, par value $100 a share. Agreement of May 1, 1905, as above. Old company's portion 83⅓ shares.

North Charleston Terminal Company.—1,050 shares of capital stock, par value $100 a share. Owned in equal amounts by 3 lessees, 1 the old company. Agreement dated December 20, 1916, between lessor and lessees.

Savannah Union Station Company.—$600,000 of first-mortgage 4-percent bonds, due April 1, 1952 (includes $276,000 of bonds reacquired and held alive in sinking fund as of January 1, 1944). Agreement dated May 1, 1902, amended March 1, 1920, between station company and 3 lessees, and old company.

Tampa Union Station Company.—300 shares capital stock $100 par value, owned in equal amounts by 3 companies, including old company and 1 of its wholly owned subsidiaries, Tampa Northern Railroad Company.

Agreement dated November 1, 1940, between station company and 2 lessees, receivers of old company and the Atlantic Coast Line Railroad Company.

Atlanta Terminal Company.—$1,600,000 of first-mortgage 4-percent bonds, due August 1, 1969. Agreement dated August 19, 1916, between terminal company and 5 lessees, 1 of which is the old company. The old company pays its user proportion of interest on total issue of $1,600,000 of bonds, but does not contribute to the sinking fund for redemption of these bonds, funds for which are provided in equal proportions by the 3 stockholders. Certain of these bonds have been redeemed and are held alive in sinking fund, but the bonds continue to bear interest. Also 1,500 shares of capital stock, $100 par, owned in equal amounts by Southern Railway Company, Central of Georgia Railway Company, and Atlanta and West Point Railroad Company.

The following securities are to be dealt with in the plan:

(1) *Obligations of receivers.*—A total amount of $11,870,000 of receivers' equipment-trust certificates will be assumed by the new company.

(2) *Seaboard underlying divisional mortgage bonds.*—A total amount of $49,467,526.68, consisting of $30,103,000 of principal and $19,364,526.68 of interest, will be settled by the payment of $2,919,440 of cash and issue of $41,493,169 of various securities.

(3) *Seaboard general-mortgage bonds.*—A total of $188,084,979.61, consisting of $94,115,500 of principal and $93,969,479.61 of interest, will be settled by the issue of $113,617,192 of various securities.

(4) *Seaboard Collateral-trust obligations.*—A total $37,194,943.18, consisting of $21,318,153.00 of principal and $15,876,790.18 of interest, will be settled by the issue of $27,275,612 of various securities.

(5) *Subsidiary railroad and terminal companies, properties of which are operated by receivers as part of the system.*—

A total of $25,215,806.33, consisting of $12,851,000 of principal and $12,364,806.33 of interest, to be settled by the payment of $2,664,850 cash and the issue of $2,454,179 of various securities. Included in this group are the Seaboard-All Florida Lines, the properties of which are to be acquired by foreclosure of the first mortgage instead of by issue of securities. Total claims against these properties amount to $16,214,103, consisting of $7,659,000 of principal, and $8,555,103 of interest. The remaining claims totaling $9,001,703.33, consisting of $5,192,000 of principal and $3,809,703.33 of interest will be settled by the payment of the cash and securities as stated above.

(6) *The Seaboard-Bay Line Co. section 210 loan-deficiency claim.*—A total indebtedness of $349,063.33, which is to be settled by the issue of $159,848 of various securities.

(7) *Unpaid interest not included above.*—A total of $522,-897.75, which is to be paid when due or when conditions of payment are complied with.

Proposed Capitalization

The proposed capitalization and the annual rental, interest, and dividend charges as of January 1, 1944, of the new company, are indicated below:

	To be issued or assumed by new company	Annual charges interest and dividend
Total fixed-interest debt		
Rentals and miscellaneous charges undisturbed		$ 110,000
Undisturbed receivers' equipment trusts	$ 11,870,000	336,000
First-mortgage 40-year 4-percent bonds, series A	32,500,000	1,300,000
Total fixed-interest debt	$ 44,370,000	
Total annual fixed charges		$1,746,000
Discretionary charges		
Capital fund, not in excess of 3¼ percent of total railway operating revenue, or $1,625,000, whichever is greater (less such amounts as may be available for capital expenditures by reason of depreciation of road property)		1,625,000
Sinking fund for first-mortgage bonds, series A, 1 percent		325,000
Total discretionary charges		$1,950,000
Total annual charges prior to interest on income-mortgage bonds		$3,696,000
Contingent-interest debt and charges		
Income-mortgage 50-year 4½-percent bonds, series A	$ 52,500,000	$2,362,500
Sinking fund for income-mortgage bonds, series A		262,500
Total fixed and contingent debt	$ 96,870,000	
Total annual charges before dividends		$6,321,000
Preferred stock 5 percent ($100 par)	15,000,000	750,000
Total par value of securities	$111,870,000	
Total annual charges against income, including preferred stock dividends		$7,071,000
Common stock, no-par, $100 stated value	85,000,000	
Total capitalization	$196,870,000	

Valuation of Properties to be Acquired

Testimony was presented at the hearing tending to show that the cost of reproduction less depreciation of the properties owned by the old company, plus value of lands and rights as of December 31, 1936, was $189,877,155. The net additions and betterments for the period December 31, 1936, to December 31, 1942, were $30,043,303. The sum of these figures is $219,920,458. On May 22, 1931, division 1 in *Seaboard Air Line Ry. Co.*, 35 *Val. Rep.* 337, found the single-sum value as of June 30, 1918, for rate-making purposes, of property of the old company owned and used to be $126,366,000, of which amount $3,866,000 was working capital. For property owned but not used the single-sum value was $510,796. For property used but not owned it was $4,615,372. As of the valuation date the recorded investment in road and equipment was $190,397,699. As of December 31, 1943, similar investment was shown to be $281,759,683, or a net increase in recorded investment of $91,361,984. If this amount be added to the single-sum value of property owned and used ($126,366,000), the sum will be $217,727,984.

Earnings From the Property

A statement furnished by the new company shows the income of the system for the 18-year period from January 1, 1926, to December 31, 1943, inclusive. The annual income available for fixed charges for the period was, in order, $14,560,040, $12,852,122, $12,354,132, $12,094,330, $6,754,033, $3,038,164, $697,800, $3,072,669, $1,980,912, $1,787,931, $3,850,123, $4,120,227, $1,778,525, $3,909,978, $4,700,319, $10,592,465, $34,057,113 and $29,162,712, which is equivalent to an annual average income available for fixed charges of $8,964,000. If the income received for the abnormally low years of 1932, 1934, 1935 and 1938 and the abnormally high years of 1942 and 1943 be eliminated, the average annual income available for fixed charges will be $7,658,317. A witness for the applicant testified that the net income available for fixed charges in the year 1940, adjusted to include the additional returns from increased traffic and reduced maintenance costs, would be $7,498,000 per annum. This amount is considered by the applicant as representative of the earnings available for fixed charges for the present and fore-

seeable future, which view we accept for the purposes of this report. The witness testified in detail regarding the bases upon which he considered the 1940 performance of the receivers of the old company would be affected both by prospective increases in the volume of traffic and lessened expenses for operation resulting from improvement of plant and equipment made in recent years. However, further discussion of that evidence seems to be unnecessary at this time.

As previously shown, the amount of the single-sum value for rate-making purposes plus the increase in investment in property from the date of valuation to December 31, 1943, is $217,727,984. The recorded investment in road and equipment on the same date was $281,759,683. If therefrom there be deducted accrued amortization of defense projects and depreciation aggregating $38,619,353, there remains a depreciated investment in road and equipment of $243,140,330. The proposed capitalization of the new company in the total amount of $196,870,000 is, therefore, materially less than the indicated investment of the old company or the probable rate-making value of the physical property to be acquired.

Earnings from the property available for the payment of fixed charges for the past 18 years have ranged from a low of $697,800 in 1932 to an all-time high of $34,057,113 in 1942 with an annual average of $8,964,644. If such earnings are adjusted by the eliminating of abnormally low returns of the depression years and the high returns of the war period, the annual average will be as previously stated $7,658,317 which supports the applicant's forecast of $7,498,000 as the earnings which might reasonably be received in the future under ordinary conditions. The average annual earnings during the entire 18-year period were sufficient to yield a return of 4½ percent on a capitalization of $199,214,000. Annual earnings determined on the basis of an adjustment, eliminating those of abnormally high and low years, were sufficient for a return of 4½ percent on $170,185,000. The applicant's forecast of normal annual earnings, if realized, would make available earnings sufficient for a return of 4½ percent on a capitalization of $166,622,000.

Clearly, the total of the proposed capital liabilities of the applicant is supported by the showing in the record regarding investment in, and probable rate-making value, on a physical basis, of the property to be continued in transportation service.

There is also support for the proposed securities from an earnings standpoint. As previously shown, the proposed capitalization will require for all annual fixed charges not to exceed $1,746,000. The applicant's forecast of $7,498,000 of earnings available would therefore exceed such charges by $5,752,000. Proposed capital and sinking funds for first-mortgage bonds, to be paid when earned, amount to approximately $1,950,000. The earnings remaining after fixed charges, reduced further by this amount, would be $3,802,000. Income-mortgage interest and sinking fund, amounting to $2,625,207, would reduce to approximately $1,177,000 the earnings remaining and available for dividends. If $750,000 be required for a 5-percent dividend on the preferred stock, there would remain $427,000 for dividends on the no-par common stock.

Upon consideration of the record we are of the opinion that the term of the first-mortgage bonds should be extended to 50 years and that of the income-mortgage bonds should be extended to 70 years. We also are of the opinion that the sinking-fund payments for the first-mortgage bonds and the capital-fund payments should be made mandatory, instead of discretionary as proposed in the plan, and so indicated above, if earnings are available therefor.

Our findings herein will be based upon the assumption that the above changes in the plan are to be made. No order will be entered herein at this time, since the proposals now before us are in a formative state and much remains to be done before the plan can be consummated, and before we can make the findings necessary to the granting of the required authority.

Assuming that the changes indicated above will be made in the plan, we find that the record supports the capitalization proposed by the Seaboard Railway Company in the plan of reorganization of the Seaboard Air Line Railway Company as modified herein, viz,

(1) The issue of not exceeding $32,500,000 of first-mortgage 50-year 4-percent bonds, series A, $52,500,000 of income-mortgage 70-year 4½-percent bonds, series A, $15,000,000 of preferred stock 5 percent, series A, of the par value of $100 per share, and 850,000 shares of common stock without par value, but with a stated value of $100 per share, and such additional shares of common stock not

exceeding 675,000 shares, as may be necessary to comply with the conversion rights of the income-mortgage 70-year 4½-percent bonds, series A, and the preferred stock, series A, that may be issued under the plan, and

(2) The assumption of obligations and liabilities under the terms and conditions and to the extent contemplated by the plan (a) of Legh R. Powell, Jr. and Henry W. Anderson, as receivers of the Seaboard Air Line Railway Company as guarantors, in respect of not exceeding $11,870,000 of receivers' equipment-trust certificates, and of such additional receivers' equipment-trust certificates, the guaranty of which may be authorized by us prior to the entry of an order herein, (b) of the Seaboard Air Line Railway Company or the receivers thereof, or both, as guarantors and lessees, in respect to the following securities: Birmingham Terminal Company first-mortgage 4-percent bonds, $323,333.33; Jacksonville Terminal Company first and general mortgage 5-percent bonds, $100,000, refunding and extension mortgage 5-percent bonds, series A, $2,400,000, refunding and extension mortgage 6-percent bonds, series B, $1,100,000, refunding and extension mortgage 4½-percent bonds, series C, $400,000; Tampa Union Station Company first-mortgage 4-percent bonds, $210,000; and as guarantors in respect of Norfolk and Portsmouth Belt Line Railroad Company 1½-percent promissory notes, $420,000; (c) of the Seaboard Air Line Railway Company, or the receivers thereof, or both, as lessee, by lease or operating agreement, in respect of the following securities, in so far as rental payments are involved: Athens Terminal Company first-mortgage 5-percent bonds, $200,000; Birmingham Terminal Company, 1500 shares of capital stock of the par value of $100 a share; Durham Union Station Company first-mortgage 5-percent bonds, $60,000, and 333 shares of capital stock of the par value of $100 a share; North Charleston Terminal Company, 1050 shares of capital stock of the par value of $100 a share; Savannah Union Station Company first-mortgage 4-percent bonds, $600,000; Tampa Union Station Company, 300 shares of capital stock of the par value of $100 a share; and At-

lanta Terminal Company first-mortgage 4-percent bonds, $1,600,000, and 1500 shares of capital stock of the par value of $100 a share, all as aforesaid.

COMMISSIONER MILLER concurs in the result.

By the Commission, division 4.

W. P. BARTEL,
Secretary.

(SEAL.)

(10)

FILED
JAN 5 1945
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1944.

No. 720.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

—o—

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants,* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

Reply Brief of Petitioners F. G. Badenhausen, et al., Constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds.

ABRAHAM MITNOVETZ,
Counsel for Petitioners, F. G. Badenhausen, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Consolidated Mortgage.

HARRY O. LEVIN,
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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 720.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

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Reply Brief of Petitioners F. G. Badenhausen, et al., Constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds.

Statement of Facts.

Before replying to certain of the points raised by the respondents' brief, petitioners find it necessary to refute certain factual assertions and inferences made by the re-

spondents in their brief, pages 5-8, to the effect that the petition contained certain mis-statements of fact which are numerically alleged. It hardly seems the function of briefs to argue disputed questions of fact but respondents' assertions challenge, in effect, the integrity of petitioners, and render it necessary to reply as briefly as possible thereto.*

1. Respondents deny that the Compromise Committee purported to act in a *judicial* capacity. However, the fact remains that the manner in which the Committee functioned, and the duties and powers it assumed, clearly indicate that they considered themselves as acting in a *judicial* capacity.

The District Court, when it appointed the Committee, designated it as a "Compromise Committee" not as a Conference Committee. The Committee's Report is entitled "Compromise Committee, Exhibit 1". The Compromise Committee's Report (R. Vol. I, p. 415) states:

> "The members of your Committee, in response to their appointment by your Honors, have considered themselves to be in the position of officers of the Courts charged with the responsibility of exercising *impartially informed judgments* based upon the many considerations and factors developed in the large and comprehensive record of these proceedings during its long course before the Special Master." * * * (Italics ours.)

(p. 417):

> "Your Committee has attempted in the Compromise proposal to give effect to the principles laid down by the United States Supreme Court particularly within the past few months, and to fit into the hierarchy of the new capital structure the contributions of the separate divisional and system

*Petitioners follow respondents numerical order.

mortgages and leased lines in such a way that each will retain in relation to the other relatively the same position as to earnings that it formerly had, and to grant to each such interest new securities which are the equitable equivalent of the rights represented by the securities and claims to be surrendered in order that the full priority rule of the *Boyd* case as applied to the rights of creditors *inter se* may be satisfied."

It appears perfectly obvious that the Committee assumed duties and powers far greater than those originally indicated when it was appointed by the District Court. The function of the Committee, as outlined by the District Court at the time it was appointed, was to negotiate a compromise wherein all participating parties were to agree to its terms. This is distinctly set forth in the record. There was no reason for the Compromise Committee to *hear* anyone. They had participated actively in all of the hearings before the District Court and knew perfectly well the claims of each of the participating parties. Their true function, which was never truly exercised, was to negotiate a Compromise between all of the interested parties. The Committee has repeatedly stated that, in reaching its results, it exercised an *impartially informed judgment*. The fact is that the Compromise Committee not only purported to but actually did assume to act in a judicial capacity. The very language used as well as the powers assumed indicate as much. That they subsequently refer to themselves as a "Conference Committee" does not change the facts. Although the Committee's Report mentioned certain general principles which purportedly guided their judgment, they have never explained in their Report, or in open court, the methods by which they obtained their results, nor did they consistently follow the principles which they stated they recognized. For in-

stance, the Committee stated in its Report (R. Vol. I, p. 419) that it recognized—

> "the fundamental principle of fairness and equity in providing for distribution of abnormal war earnings to holders of securities whose properties have produced such earnings."

The abnormal war earnings in this case were in excess of $34,000,000 but the Tertiary Allocation recommended by the Committee, which purported to distribute these abnormal war earnings to holders of securities whose properties have produced such earnings, only distributed on that basis, according to the respondents' own version, approximately $12,000,000, or about one-third of the abnormal war earnings.

2. The respondents deny that the securities allocated to the Georgia and Alabama Bonds were valued at certain specified amounts. They assert that no dollar values were assigned by the District Court to any of the new securities. Respondents infer that the alleged values used in the brief of the petitioners were "a guess", not based on any evidence in the record or upon any findings made by the Special Master or the District Court. Respondents omit to mention that when the Special Master sought to compensate the senior liens, in cases where a portion of the value of the property subject to the senior liens was allocated to holders of junior liens secured on the same property, he did so by using a valuation of $1,000.00 for each $1,000.00 First Mortgage Bond, $500.00 for each $1,000.00 Income Bond, $25.00 for each $100.00 share of Preferred Stock and $12.50 for each share of Common Stock and that this procedure was approved by the District Court. If this base was fair and sound for the aforesaid purpose, it is equally sound for estimating the valuation of all the securities allocated to the Georgia and Alabama

Bonds. It is true that the estimated value of these securities made by the Special Master cannot be accurate and depends upon the market value of the securities which, of course, fluctuates, but in any event it represents a close approximation and the valuation which the Special Master fixed in his own mind as to the securities awarded and hence as to the final valuation of each of the Mortgage Divisions.

3. Respondents question the fact asserted in the petition that the huge wartime earnings were due mostly to traffic contributed by the various Underlying Divisional Lines, and that all the Underlying Divisional Lines were earning huge sums during the years 1942 and 1943, particularly those lines which were denoted as "deficit" lines. They state that there is no evidence to support this statement. The record, however, speaks for itself. Aside from the fact that the General Mortgages constituted Secondary Mortgages on all of the Underlying Divisions, and in minor instances First Mortgage liens on certain lines, the bulk of the equity of the General Mortgages lie in their lien on certain funds or securities and properties owned by the Seaboard System, in addition to their lien on the equipment owned by the System. The rents and interest charges earned by the equipment and properties on which the General Mortgages have a first lien remain practically constant, irrespective of the amount of business or traffic carried by the System. On the other hand, the Underlying Divisional Lines, which carry most of the traffic of the System, are the backbone or heart of the System and immediately reflect and show an increase in earnings as the traffic is increased. It necessarily follows that as the wartime traffic increases the wartime earnings of these divisions increases proportionately, the increase in earnings therefore must be due entirely to the various Underlying Divisional Lines.

Contrary to the respondents' assertion, the record (R. Vol. I, 158-163, 211-213) clearly shows that the "deficit" lines showed an increase in earnings during the war years *relatively* much greater than that shown by the lines which had been profitable prior to the war. This was clearly illustrated by the expert Wyer's testimony (R. Vol. I, pp. 211-213, 158-163) and by his Court Exhibits Nos. 1 and 2 (R. Vol. 1, pp. 409, 410). It is a natural phenomenon of all railroads that, as the business of the railroad increases, not only do the earnings increase proportionately, but the overhead decreases inversely. The "deficit" lines, mathematically, must show a greater relative increase than the lines which had been profitable previously since the cost of the "earning" divisions was always maintained at a low level. Wyer's testimony and Court Exhibits 1 and 2, which were not refuted, clearly prove that the increase in earnings of any "deficit" line during the war years must relatively be much greater than any of the so-called prewar "earning" Divisions.

4. Respondents deny petitioners' assertions that the Underlying Bondholders Committee "favored the so-called 'earning Divisions' represented by it", and for all practical purposes abandoned the true representation of the so-called "deficit Divisions". To support that denial respondents make the assertion that every argument or contention made by these petitioners in the District Court was also made by the Underlying Committee on behalf of the Georgia and Alabama and other deficit lines. Nothing could be further from the truth.

During the course of the reorganization hearings, petitioners filed a petition in the District Court for an order directing the Underlying Bondholders Committee, who purported to represent ten of the Underlying Divisions, to cease to represent Georgia and Alabama Division, on the ground that there was a conflict of interest. The

hearing on this petition was deferred by the District Court until after the reorganization hearings. The answer of the Underlying Committee *admitted* that there was a conflict of interest between the various issues of Underlying Bonds as to the Plan of Reorganization to be adopted, but sought to justify their position on the ground that there were many mutual interests and advantages to be gained by presenting a united front. Mr. Baetjer, chairman of the Underlying Committee, who testified, admitted that a conflict of interest existed between the various Mortgage Divisions the moment there was a limited common fund to be divided among them. Mr. Baetjer testified at this hearing that he contemplated making all of the good bonds whole but was *prepared to make some concessions for three poor issues.* He further testified that he considered the Georgia and Alabama one of the three poor issues, which would not receive full payment of their claim. The record and final allocations recommended by the Compromise Committee clearly disclose that all of the so-called Underlying "earning" divisions benefited far more greatly than the so-called "deficit" lines, by reason of the Compromise recommended by the Committee. As stated by the District Court (R. Vol. I, 116-117) the *principal objection* of the Underlying Committee was in the treatment of deficits, which affected only the so-called *"earning"* divisions. It is clear therefore that the Underlying Committee *did favor* the so-called "earning" divisions represented by it.

It is true that several of the contentions advanced by petitioners were also made by the Underlying Committee but it is likewise true that many of the arguments made by the petitioners were not made by the Underlying Committee. Counsel for petitioners attacked both the Secondary and Tertiary Allocations of wartime earnings. Petitioners actively contended that the Kennedy Segregation Formula adopted was inequitable and unfair and

exposed the fallacies and defects of the adopted Segregation Formula. Counsel for petitioners alone stressed the amount of salvage value of the Georgia and Alabama Railway, which the Receivers stated amounted to $1,200,000 and counsel for petitioners alone stressed the enormous contribution made by the Georgia and Alabama Railway to the freight revenue of the entire system which, during the average year 1936-1940, amounted to $1,945,365. Counsel for petitioners alone demonstrated that even in 1939, when under the Kennedy Segregation Formula the Georgia and Alabama Railway purportedly had a deficit of $221,000, the Georgia and Alabama Railway contributed net freight revenue to the balance of the system $922,567. It will be seen from the foregoing that the statements made by the respondents are distorted and inaccurate.

5. Respondents take issue with petitioners' statement that the Tertiary Allocation "applied to only a small portion of the new securities released". Respondents assert that the Tertiary Allocation actually disposed of approximately $12,000,000 in cash and securities of the wartime earnings. It will be recalled that the wartime earnings and securities released by wartime earnings were in excess of $34,000,000.

It must be admitted that the facts with respect to the amount of securities involved in the Tertiary Allocation are not at all clear from the Court record and exhibits. The Court record, with the exception of the District Court Opinion, contains nowhere any direct or indirect statement as to the amount of securities involved in the Tertiary Allocation. In addition, the proceedings of the Compromise Committee were kept highly secretive. No indication was given by the Compromise Committee as to what the recommended modifications would be until the very day set for the hearing to approve the Plan of Reorganization, as modified by the Compromise Committee.

The statement made however by the petitioners as to the amount of securities involved in the Tertiary Allocation was not an arbitrary guess on their part but was predicated, as stated on page 37 of their brief, on the facts stated by Judge Chesnut in his opinion (R. Vol. I, p. 125), which describes the Tertiary Allocation as applying only to a small amount of securities released by the cash provisions made for the acquisition of Tampa Northern and Georgia, Florida & Alabama Bonds. Assuming that the District Court was in error and that the respondents' version is correct, it still appears that the Tertiary Allocation applied to approximately only one-third of all the securities and cash acquired by the wartime earnings. It also appears that the Compromise Committee has not followed the fundamental principle advocated by it in its Report (R. Vol. I, p. 419), to wit, "the principle of fairness and equity in providing for distribution of abnormal war earnings to holders of securities whose properties have produced such earnings". It still appears that the balance of the wartime earnings, approximately two-thirds thereof, is distributed (pursuant to the Secondary Allocation) on a pre-war basis only among such Divisions as showed earnings during the period 1936 to 1940. Mortgage Divisions, such as the Georgia and Alabama Railway, which have had large earnings during the wartime period and which have contributed heavily to these cash purchases, receive no part of the balance of these securities since they showed no segregated earnings in the period 1936 to 1940 under the Segregation Formula adopted.

Replying to Point I of Respondents' Brief.

Respondents contend that there is no conflict between the decision of the Circuit Court of Appeals in this case and the Circuit Court of Appeals for the Second Circuit in the *"Rutland"* case.

Respondents distinguish the *"Seaboard"* case from the *"Rutland"* case on the ground that the Seaboard Receivership had begun *before* the enactment of Section 77, whereas the Rutland Receivership had been begun *after* the enactment of Section 77.

Respondents state that the institution of the Seaboard Receivership in 1930 could not have been a violation of any congressional policy announced in 1933, when Section 77 was enacted.

But the issue here is not the institution of the Receivership—it is the *reorganization* of the railroad. In both cases the reorganization proceeded long after the enactment of Section 77. In the *"Seaboard"* case the proceedings to reorganize in the District Court were commenced in 1939—six years after the enactment of Section 77.

The District Court herein, in its opinion (R. Vol. I, p. 142) admitted that the primary reason which prompted the enactment of Sections 77 and 77b of the Bankruptcy Act was that equity procedure in corporate reorganizations had heretofore in many cases proved unsatisfactory. Nevertheless the Court proceeded to reorganize in equity receivership.

It is self-evident that the principles enunciated by the Circuit Court of Appeals for the Second Circuit are equally applicable to the instant case, when the reorganization began long after the passage of Section 77.

That the existing conflict in the law is confusing to other courts is clearly indicated in the case of the Wisconsin Central Railway. The Wisconsin Central Railway was in receivership since December, 1932, *before* the enactment of Section 77. Proceedings to reorganize were commenced in equity, and were pending, the situation being very similar to that of the *"Seaboard"* case. Thereafter the *"Rutland"* case was decided by the Circuit Court of Appeals for the Second Circuit. According to published reports, petitioners understand this decision influenced the District Court to place the Wisconsin Central Railway

in bankruptcy and to proceed in bankruptcy with the reorganization of the railroad.

It is clear that this conflict and the important question of law raised thereby should be finally and authoritatively settled by this Court.

Replying to Point II of Respondents' Brief.

Respondents on pages 9 and 10 and Point II of their brief contend that "petitioners did not object in the District Court proceedings to the appointment of the Committee or to the membership of the Committee, nor did they raise any question as to the propriety of the appointment of the Committee or its membership in their appeal to the Circuit Court of Appeals. They have waived any right to object at this stage of the proceedings".

If the facts asserted by respondents were true or fully disclosed, their contention may be sound, but the facts are not true nor fully disclosed.

Respondents infer that petitioners did not raise before the Circuit Court of Appeals the objection to the Compromise Committee and its recommendations that it now raises before this Court. Nothing could be further from the truth.

Petitioners in Point 8 of their brief before the Circuit Court of Appeals raised exactly the same contentions that they now urge in Point 2 of their brief in support of their petition for a writ of certiorari. In fact, the language used in Point 8 of petitioners' brief before the Circuit Court of Appeals, except for minor changes, is identical, word for word, with that used in Point 2 of petitioners' brief before this Court.

If respondents admit that the petitioners' brief now raises serious objections and questions with respect to the Compromise Committee, they must also admit that the same objections were raised before the Circuit Court of Appeals.

Respondents also assert that at the time when the Compromise Committee was appointed, the petitioners did not object to the Committee or to its membership. This fact is true, but all of the facts are not being fully disclosed.

Before the District Court appointed a Compromise Committee, the Court discussed the practical business aspect of deciding the issues before the Court on a compromise basis rather than on a legal or judicial basis, in order to expedite the reorganization at the time when the earnings of the System were at the highest level (R. Vol. I, pp. 365, 368). The District Court urged that all of the active participating parties try to come to a definite *agreement by consent* as to a Plan of Reorganization so that the Court could confirm the Plan with the modifications agreed upon by the parties (Ct. Tr. pp. 1351, 1354, 1369, 1370).* At the time the District Court discussed compromise the Court also rendered its tentative opinion and specifically stated in such opinion that the Georgia and Alabama Division was being unfairly treated under the proposed Plan of Reorganization (R. Vol. I, p. 360). Counsel for petitioners was specifically asked, at the time compromise was discussed by the Court, whether he would be willing to agree to compromise, to which he replied in the affirmative.

Mr. Sunderland, who was subsequently appointed Chairman of the Compromise Committee and who represented the Trustees of the System's largest general mortgage, in suggesting the appointment of a Compromise Committee, and stressing the advantages to be gained thereby, stated that the objective was to make an *agreement to agree* on the various issues between the interested participating parties (Ct. Tr. p. 1332). The District Court, in discussing the compromise, specifically stated:

*The Court Transcript pertaining to the Compromise is not contained in the printed record on appeal. However, the original record of the Court Transcript has been certified and is on file in the Clerk's Office of this Court and available for examination.

"The Court: What I want to ask you gentlemen is this: Mr. France and Mr. Andrews and to the extent Mr. Sunderland feels interested and the others are interested, decide these two outstanding questions and if you can't decide them any other way, divide them in half. That ends that dispute and it is the major dispute in the whole case. You and Mr. Andrews and Mr. Sunderland or somebody else get together on one side of the table and deal with these individual roads that seem to think they have been unfairly treated and say what you will each give up to them in addition to what they have. If you do that you end the problems, you agree upon your plan. There are some minor things that would still have to be ironed out. I have got to decide this question of law about the preferred stock of the Seaboard & Roanoke. That is a pure question of law. I can certainly do that in a few days. I will undertake that trouble and have that question decided in probably two or three days after I get the briefs of counsel. In the Georgia & Alabama there is the contention that they are not fairly treated for the reasons indicated. Mr. France on one side of the table and Mr. Andrews and Mr. Sunderland on the other can deal with Mr. Mitnovitz, assisted by the friendly counsel of Mr. Rothchild and say what both of you are willing to give up in view of their situation. The same way with the Atlanta-Birmingham. I don't see any reason why people who have their main eye on getting through with it should not agree in a couple of hours" (Ct. Tr. pp. 1369-1370).

It clearly appears from the record, the District Court suggested that a Compromise Committee be appointed to negotiate with the interested parties whose rights appear to be adversely affected by the Master's Plan, so that a Plan of Reorganization be confirmed which would be

agreeable *by consent*, to all interested participating parties (Ct. Tr. pp. 1314-1386).[1]

The fact that the Compromise Committee was composed of partial major interests was of no importance, if all of the parties were to agree and compromise their differences. In fact, it was necessary to have the major interests approve any compromise, before it could become effective. No reason existed for the petitioners to object to the Committee or its membership if the procedure outlined by the District Court was followed. However, the procedure outlined by the District Court was never followed. The Compromise Committee assumed and purported to act in a judicial capacity. It never attempted to negotiate or discuss terms of compromise with the petitioners. The Committee merely asked petitioners to express their views as to the terms of compromise.

After the Compromise Committee submitted its Report and made its recommendations, petitioners did object to the procedure and methods used by the Compromise Committee, and stated that it had never consented to the proposed modifications. This statement appears in the Transcript of the Court Record, pages 1495 to 1501, which is on file in this Court. Petitioners admit that it is a proper and useful function in reorganization to compromise differences in order to avoid unnecessary litigation, but a compromise is necessarily based upon mutual consent of interested parties. The difficulty in the instant case is that the word "compromise" has been used promiscuously but the sense of the word has never been observed.

Replying to Point III of Respondents' Brief.

Respondents assert that no questions of "compensation" to the Georgia and Alabama Bonds arises in this

1. The Court Transcript pertaining to the Compromise is not contained in the printed record on appeal. However, the original record of the Court Transcript has been certified and is on file in the Clerk's Office of this Court, and available for examination.

case. Respondents assert that a senior creditor is entitled to compensation for the loss of senior rights if he is required to take inferior securities, but only if junior securities were also allowed to participate. However, in the *"Milwaukee"* case, this Court held that in a railroad reorganization, the true principle is that each divisional mortgage must receive sufficient securities in the new corporation, so that each will retain, in relation to the other divisional mortgages, the same position it formerly had in respect to assets and of earnings at various levels.

Can it be fairly said, in view of the securities which the Georgia and Alabama Railway receives under the Plan of Reorganization, that the Georgia and Alabama Division retains, in relation to the other Mortgage Divisions, the same position it formerly had in respect to assets and of earnings, paricularly when it was a first mortgage on 393 miles of railroad which earned in 1942, even under the Kennedy Segregation Formula (which petitioners contend is unfair and erroneous) over $1,016,937? Under the Plan of Reorganization the Georgia and Alabama Railway receives First Mortgage Bonds in the sum of $357,408; Income Mortgage Bonds in the sum of $1,597,627; Preferred Stock in the sum of $656,461 and Common Stock in the sum of $3,739,875. On the valuation set for these securities by the Special Master, the Georgia and Alabama received securities valued at $1,805,880.00.

The Master's Report, Exhibit A (R. Vol. II) clearly shows that the Georgia and Alabama Division contributed to the balance of the System on freight contributions during the average year 1936-1940, $1,945,365. Even in 1939, when under the Kennedy Segregation Formula, the Georgia and Alabama Railway purportedly had a deficit in the sum of $221,000, the Georgia and Alabama Railway contributed in net freight revenue to the balance of the System $922,567 (R. Vol. I, S. M. Exhibit, 415, p. 591).

It is clear that the Georgia and Alabama Railway earned, even under the Kennedy Formula, in 1943, and in the year 1944, the same amount, if not more than, it earned in 1942. Mr. Wyer testified that he estimated the earnings of the Georgia and Alabama Railway in 1943 to be anywhere between $1,500,000 and $2,000,000 (R. Vol. I, 160-161). In addition, petitioners have clearly shown that the net salvage value or junk value of the Georgia and Alabama Railway and its terminal, lands and buildings, *excluding* rights of way, amounts to $1,200,000. The record clearly discloses that the Special Master, in estimating the value and earnings of the Georgia and Alabama Railway, failed to give any consideration whatever to the earnings of the Georgia and Alabama Railway during the years 1941, 1942 and 1943.

It is perfectly obvious that if the present Plan of Reorganization is approved, the Georgia and Alabama Division by no means retains, in relation to the other Mortgage Divisions, the same position it formerly had in respect of assets and of earnings, particularly when the bulk of the securities received (which are inadequate in the first instance) are inferior securities of junior grade.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Respectfully submitted,

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HARRY O. LEVIN,
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